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The Province of Alberta

IN THE MATTER OF "THE NATURAL
GAS UTILITIES ACT"

—and—

IN THE MATTER OF an Enquiry into
Scheme to be adopted for Gathering,
Processing and Transmission of
Natural Gas in Turner Valley

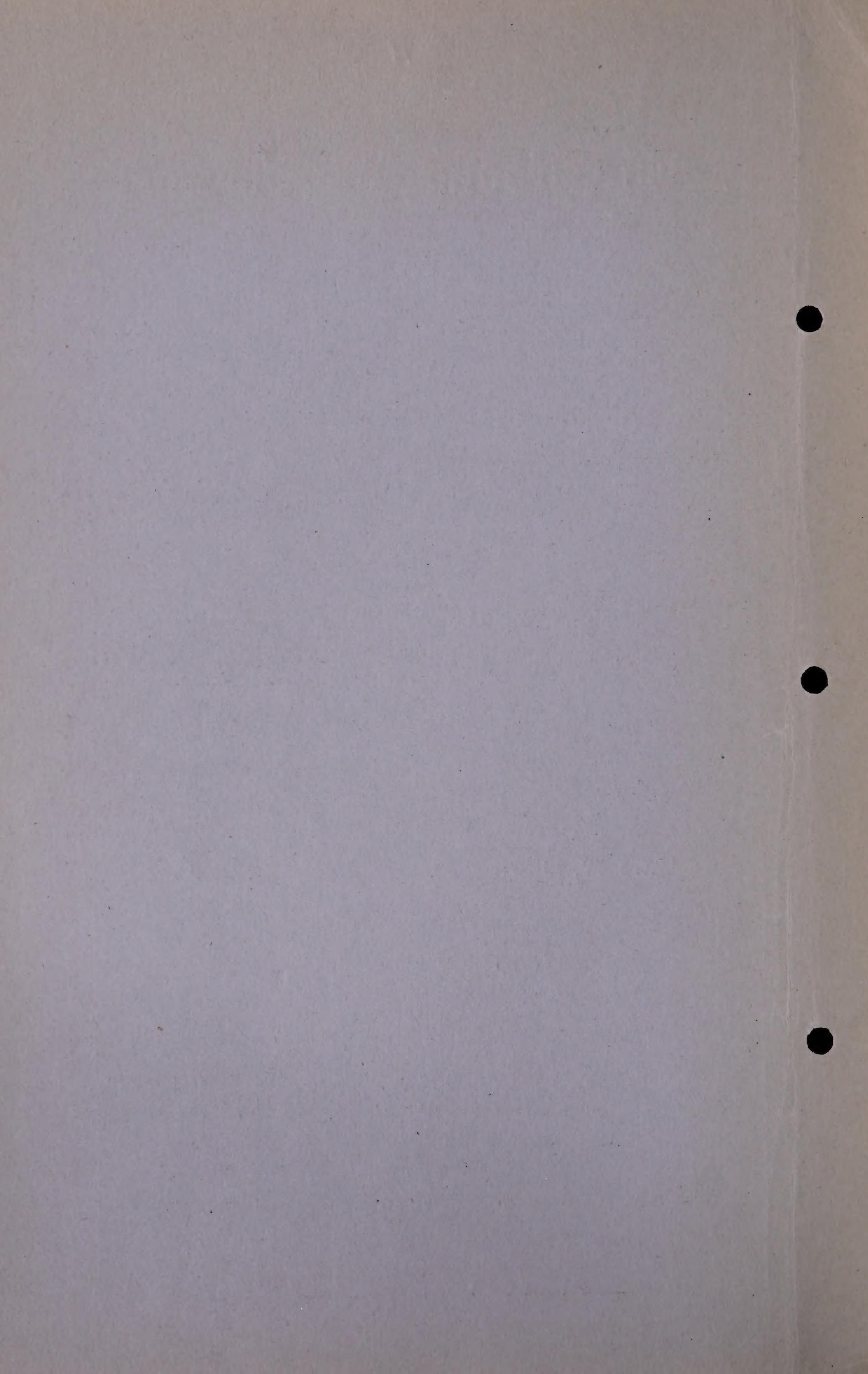
G. M. BLACKSTOCK, Esq., K.C., *Chairman*

Dr. E. H. BOOMER, F.C.I.C., *Commissioner*

Session:

CALGARY, Alberta April 16th, 1945.

VOLUME 23



I N D E X

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16th April, 1945.
9.30 A.M. Session.

EDGAR G. HILL, Recalled, examined
by Mr. Chambers testified as follows:

MR. MILNER: Mr. Chairman, before we start.

I might say Mr. Steer is in the hospital with a touch of laryngitis and he will not be here today and tomorrow and may not even be here on Wednesday. It may be understood that any witnesses that are here to give evidence in his absence may be recalled by him for cross-examination.

THE CHAIRMAN: Yes.

MR. CHAMBERS: That is excepting Mr. Hill.

MR. MILNER: It is understood that any questions that Mr. Brownie or Mr. Wegé may wish to ask Mr. Hill, perhaps they could put them through Mr. Blanchard. I have spoken to Mr. Blanchard and he is willing to do that.

THE CHAIRMAN: Quite all right.

Q MR. CHAMBERS: Mr. Hill, you are still under oath?

A Yes, sir.

MR. CHAMBERS: If the Board pleases, I wish now to put in the map that was attached to Exhibit 59, a copy of the map which was attached to Mr. Hill's original report. This can probably be made part of Exhibit 59.

THE CHAIRMAN: I think that is proper. There is just the one copy?

MR. CHAMBERS: That is all. We did not make them for the extra copies. That copy can be attached to the Exhibit by the Court Reporter.

MR. HARVIE: What map is it?

MR. CHAMBERS: It is the map which was produced by Mr. Hill and attached to his original report, Exhibit 59.

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Q Mr. Hill, during the course of your cross-examination, there was some reference made to your computations of the average age of the pipeline and I understand that over the week-end you have given some thought to that and have some more information for the Board.

A I have. I have that made up in Exhibit form, the data upon which I made the calculations and arrived at my 7 year average life.

STATEMENT "AVERAGE AGE OF PIPELINE SYSTEM AS REVEALED BY INSPECTION MADE NOVEMBER 1943", NOW MARKED EXHIBIT 65.

Q Would you just enlarge on that, Mr. Hill, please?

A The first column shows the size of the pipes. The next column towards the right, the inspection number, and the third column the year the pipe was laid as reported to me by the employee of Royalite who took me around on my inspection trip, that is Mr. Dodds. I made an inspection of the pipe at each of those locations and I asked Mr. Dodds when that line was laid and the information which is contained in the third column, the dates are those which he gave me. The right-hand column is the age in years as produced by subtracting the date when it was laid from the date I made the inspection. That is my inspection was in November, 1943 and I assumed that the lines were laid in the middle of the year in the third column. For each size of pipe I averaged the age. Then I took the dollar value of the pipe of each size and multiplied it by the average age of each size and got the dollar results which I did. Then I divided into that dollar result the total value of the pipe, which gave me a weighted average age of 6.96 years or approximately the 7 years as I said in my report. Regarding the inspection number in the second column of that report, in November 1943 I made about 70 inspections of the pipe of which half approximately

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were made for the Valley Pipeline and the other half for the Royalite Gas Division and the inspection numbers in the second column correspond with the numbers in my notes as I made the inspection of the pipe. I think that the result which I have arrived at is a fair sampling - a fair result arrived at by the sampling method. I picked the location of the inspection at random on the Royalite Pipeline map before I started work and I picked those inspection locations without any knowledge of age of the pipe or the condition of the ground at the location. I tried to get a representative number of inspections which would have some bearing on the relative amount of money involved in each size of pipe and that is my result.

Q DR. BOOMER: You did not weight the average?

A I took the arithmetical average of each of the various sizes and I weighted and got the age of the pipe and I weighted that on page 2. You will note that is weighted.

Q Yes.

A Page 1, I just assumed that all of one size of pipe was worth the same, that is there were slight differences depending on weight.

Q I mean when you say six-inch pipe, six-inch pipe $11\frac{1}{2}$ years old, it might be very much longer than the six-inch pipe that is only half a year old.

A That is the inherent error in that form of arriving at a weighted average age. I did not know anything about the age of the pipe before I started. If I had taken 200 inspections I would have got perhaps a little better answer. But that is how I did it.

Q MR. CHAMBERS: Then, Mr. Hill, there was some questioning during your cross-examination of the age of the heaters.

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A Yes.

Q You made some study of that?

A I did, yes. I made some inquiries over the week-end or after my cross-examination and I found that the oldest heater was installed in 1936.

Q You have a statement as to that?

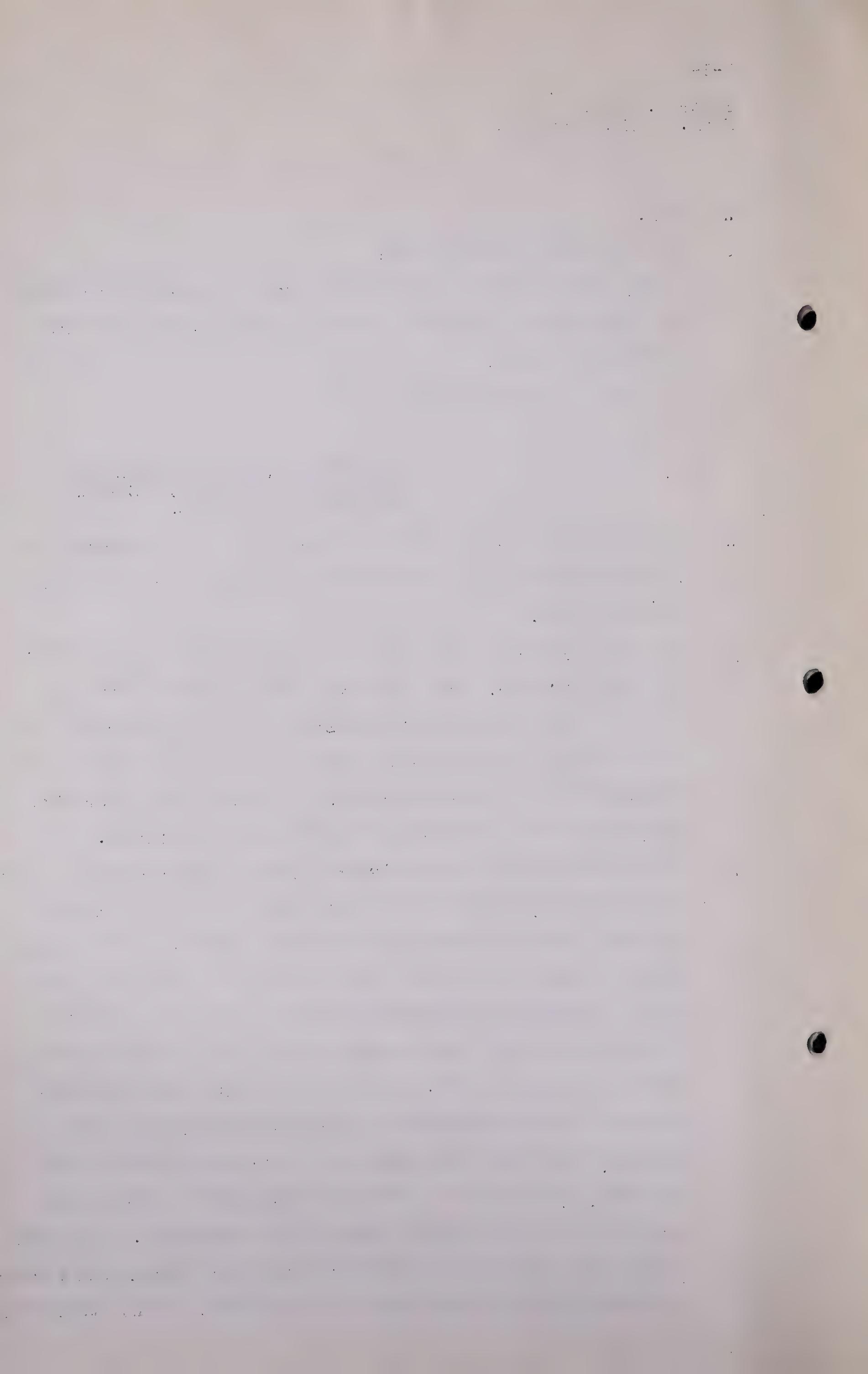
A Yes.

STATEMENT "DATE OF INSTALLATION OF
HEATERS IN NATURAL GAS SYSTEM",
NOW MARKED EXHIBIT 66.

A The oldest heater was about $7\frac{1}{2}$ years old and the average age of the heaters as can be weighted out from that Exhibit was about 5 years.

Q Mr. Hill, regarding the 9 per cent overhead that you allowed for in Exhibit 59. Now you have already told us that you have had wide experience in the States and some experience in this country as to the actual overhead charges in large types of construction. I would like you to enlarge on that or give us some specific instances as to what you had in mind.

A My experience in the United States covers construction of properties ranging in cost from 11 million dollars to 22 million dollars. That is natural gas properties ranging between those ranges in cost. In Canada, my experience is confined to one company, Northwestern Utilities Limited, Edmonton, of which I had charge of the construction in 1923 and I was President of that company in 1923 and 1924. In the States I was Vice-President and General Manager of the Southern Natural Gas Company, which was built under my firm's supervision in 1929 and 1930. At the time, I was an officer of the company and knew about its cost from my own personal knowledge. Of course I knew about the Northwestern Utilities cost from my own personal knowledge, being President of the company. I have taken the



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two companies of which I was an officer and have listed the prime cost of the project, that is the cost of the materials and labour that went into the construction of each of them and then the cost of the general overhead as they were generally expended on both those properties.

Q And those were each new projects starting from scratch?

A They were new projects starting from scratch.

MR. CHAMBERS: I would like to put this in for the Board's information. Mr. Hill has made a compilation over the week-end. Have you got copies of it?

A Yes, I have. I have only two copies here but I have had further copies made that will be here in a few minutes if they are not here now.

STATEMENT "UNDISTRIBUTED COSTS IN RELATION TO PRIME COST OF TWO NATURAL GAS PROJECTS ON WHICH FORD, BACON & DAVIS, INC. ACTED AS ENGINEERS" NOW MARKED EXHIBIT 67.

MR. McDONALD: What is that?

MR. CHAMBERS: It is a break-down, giving the overhead costs of two companies.

Q What are the two companies?

A Northwestern Utilities Limited, Edmonton and The Southern Natural Gas Company of Birmingham, Alabama.

Q Now would you go over that exhibit and explain it to the Board?

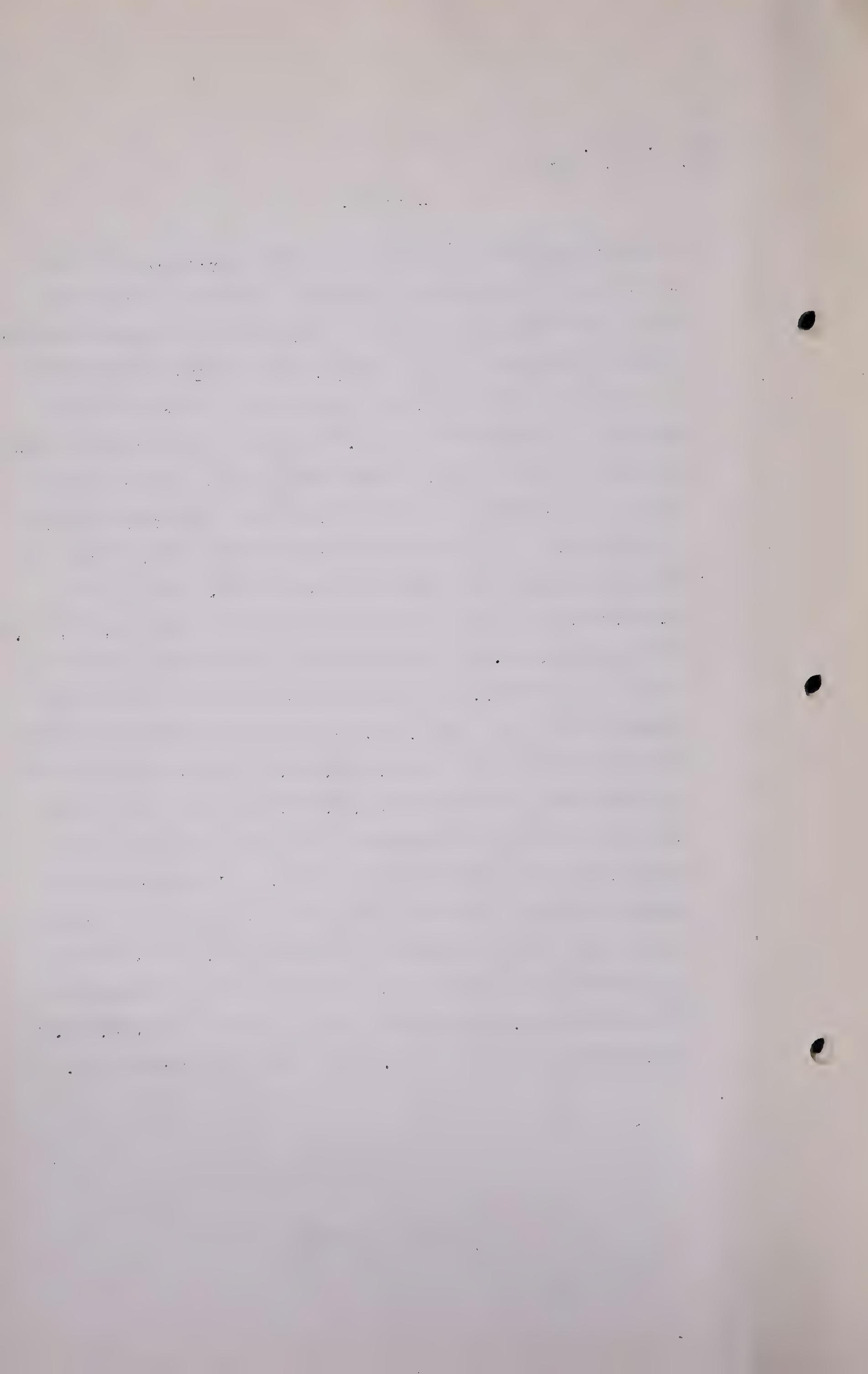
A The Exhibit is entitled "Undistributed costs in relation to Prime cost of two Natural Gas Projects on which Ford, Bacon & Davis, Inc. acted as Engineers." The prime cost of the project include: Labor and Materials comprising permanent construction, land, rights of way and other prime costs directly incurred and allocated to specific component parts of the project; for the Southern Natural Gas Corporation the prime cost amounted to \$18,911,282 and for the Northwestern Utilities, \$2,526,384.



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The Undistributed Costs which were what I referred to in my report and my computation as General Overhead for Southern Natural Gas Corporation totalled \$3,631,203 and for Northwestern Utilities, Limited a total of \$428,582. The Percentage which the Undistributed Costs bore to the Prime Cost of Southern Natural Gas Corporation was 19.20 percent and for Northwestern Utilities 16.96 per cent. That Undistributed Cost is broken down to its component details on the second and third pages of the Exhibit. On the second page the Undistributed Costs, of Southern Natural Gas Corporation are listed. They total \$3,631,203.25 and are made up of organization cost \$1,438,430.56, franchises \$3,394.75; engineering and supervision during construction, \$987,779.91; general officers and clerks salaries during construction, \$232,476.31; general officers and clerks expenses during construction, \$53,319.83; office supplies and expenses during construction, \$90,500.83; Those three total 1.99 per cent of the prime cost. The legal expenses were \$82,646.26 or .44 per cent of the cost. Insurance during construction, \$3,800.51 or 2/100 of 1 per cent of the prime cost, taxes during construction were \$10,755.10 or 5/100 of 1 per cent of the prime cost. Interest during construction \$697,430.32 or 3.69 per cent. Other expenses were \$30,668.67 which makes up a total of 19.2 per cent of the prime cost.



I know what made up those organizations costs, that is the amount, it was abnormally high costs for one thing. They paid out a million dollars for what they got to the Company from which they bought. They had accomplished certain things, they had certain gas contracts and then they sold out to a second promotion group for a million dollars so that \$1,438,000 includes that single transaction.

Q Are the financing costs included?

A The financing costs are not included.

Q I have read in some of the books on public utilities that in dealing with this subject of general over-head, that they vary from 10 to 20% and I would like you to tell us what you have to say as to that in the light of your experience, aside from public utilities companies or any kind of company.

MR. BLANCHARD: Excuse me, does that include financing?

MR. CHAMBERS: No.

THE WITNESS: My own experience is one that it has been slightly over 9% to this Southern Natural Gas of 19.2% so that my experience is fairly close to the figures you have mentioned of 10 to 20.

Q Now I think you told us that in the Edmonton Gas Company the figures shown on your Exhibit 67, there is nothing included in that for financing?

A Nothing in there for financing costs.

Q Have you any knowledge of the financing or how it was done in that case?

A My recollection of the Edmonton financing is not as good as it should be but I know that the substantial part of the construction costs was provided by the sale of first mortgage bonds and that those bonds were sold to the



distributor, to the banker that distributed them, at considerably less than par. My recollection is, I have not anything here other than recollection but I would say that the price which the company received for its first mortgage bond proceeds was approximately 90, it may have been 88 or 92 but that is about what it was.

Q There was a discount?

A There was a discount and the same applies for the Southern Natural Gas Company. Those bonds were sold at a discount likewise. The Southern Natural Gas Company raised a large part of its money from the sale of preferred stocks which were likewise sold at a discount, that is the Company received less than par for them. I know that and I also know that the bonds were sold to the public at less,- were sold to the distributor at less than par. The exact amount I cannot say but it was not par, but it was not quite as much discount as in the case of the Northwestern Utilities.

MR. CHAMBERS : That is all, Mr. Hill.

THE CHAIRMAN: Mr. Harvie?

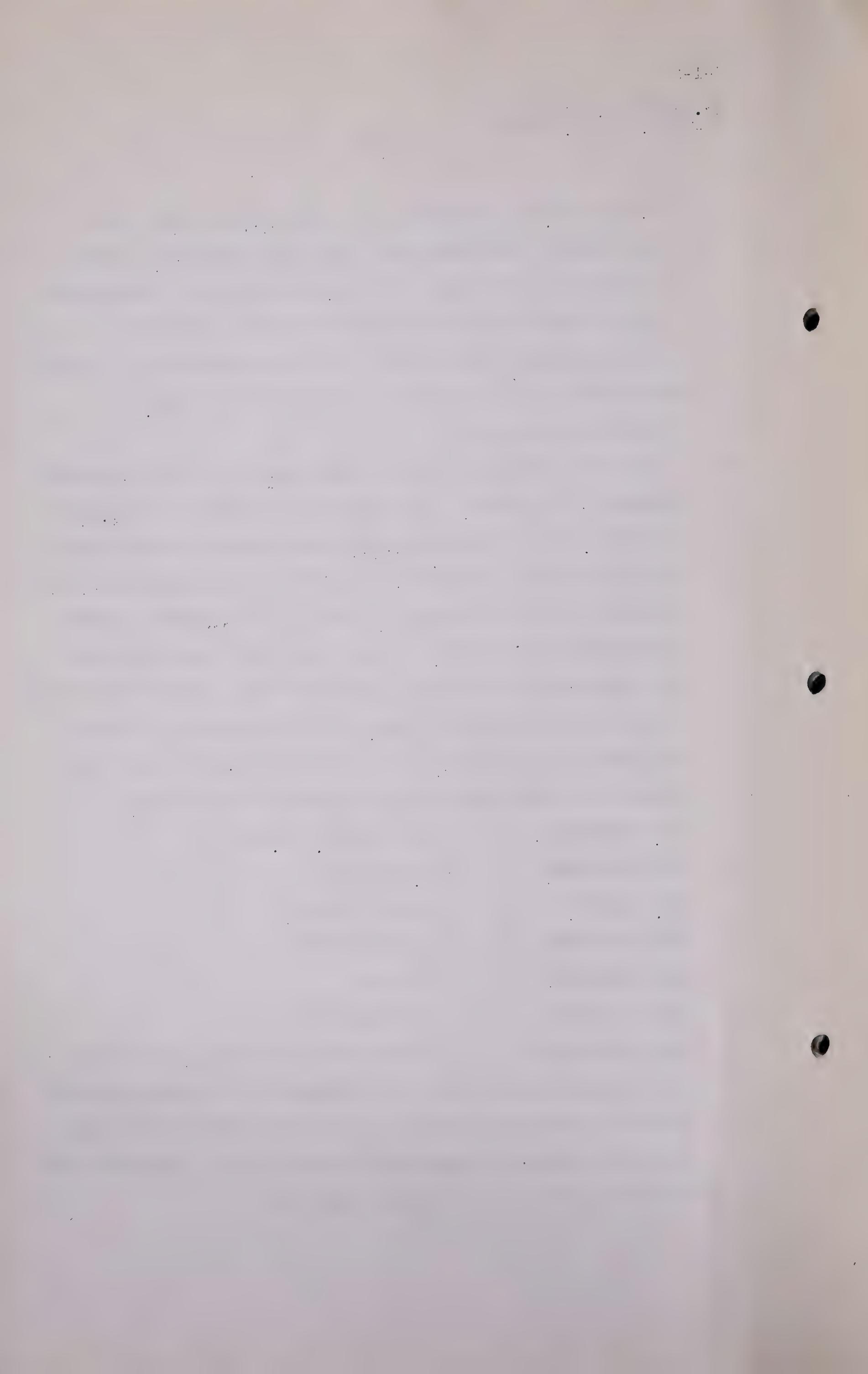
MR. HARVIE: I have nothing.

THE CHAIRMAN: Mr. McDonald?

MR. MCDONALD: Nothing.

THE CHAIRMAN: Mr. Blanchard?

MR. BLANCHARD: I have some questions that do not arise perhaps out of the cross-examination this morning but I want to ask some questions to get some information which may form a basis for comparison between your appraisal and the submissions of the British American.



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RE-CROSS-EXAMINATION BY MR. BLANCHARD:

Q. I do not want to ask you to comment at all on the appraisals of the British American submissions but I would like to know certain things so that there maybe a basis of comparison. Now in your appraisal and report, M-6, and referring to the gas gathering lines account, I would like to know.....

MR. HARVIE: What page?

MR. BLANCHARD: Well that is on pages 26 and 27, of M-6. I would like to know whether your unit costs for pipes include all fittings such are described in the gas gathering lines account of the British American submission 2-A; I do not know that you have that submission before you but I am referring particularly to page 3 of that submission, which no doubt will later be put in as an exhibit, and rather than read into the record each item, may I ask you to look at the items which are put on pages 3 and 4 under the heading "Valves, fittings, meters, etc" and tell me whether your unit costs include those items (Submission handed to Witness).

A My unit costs for pipe line material include a per foot allowance in cents per foot for the valves and fittings which are shown in the middle of page 3 of the British American Exhibit.

Q And at the top of page 4 also?

A I think that the fittings marked "at well" are substantially, make up the meter setting which I had not included in my pipeline account but put under "Meters Account" by a lump sum of \$400. for each setting of meters.

Q Yes.

A I say part of it is included and part of it is not.

Q So that the meter, the meter and meter settings referred to on pages 3 and 4 are not included in your unit costs?



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A Not for the pipe line.

Q Yes. Now then would you indicate or can you indicate what are meter fittings on those two pages and we can perhaps have this applied to the others?

A Well where there is a listing in the category "at well", it starts off with one "orifice meter" and it is followed by a group of fittings and then at the end of that group it is totalled, valves, fittings, meters and so forth. I will say of that total of \$667.97 there, \$134.34 is included in my pipe line unit prices.

Q Is included?

A Yes, and \$533.63 is included in the meter settings.

Q And in your appraisal of meters and meter settings what did you allow for meter?

A The meters.

Q Do you want to refer to M-6?

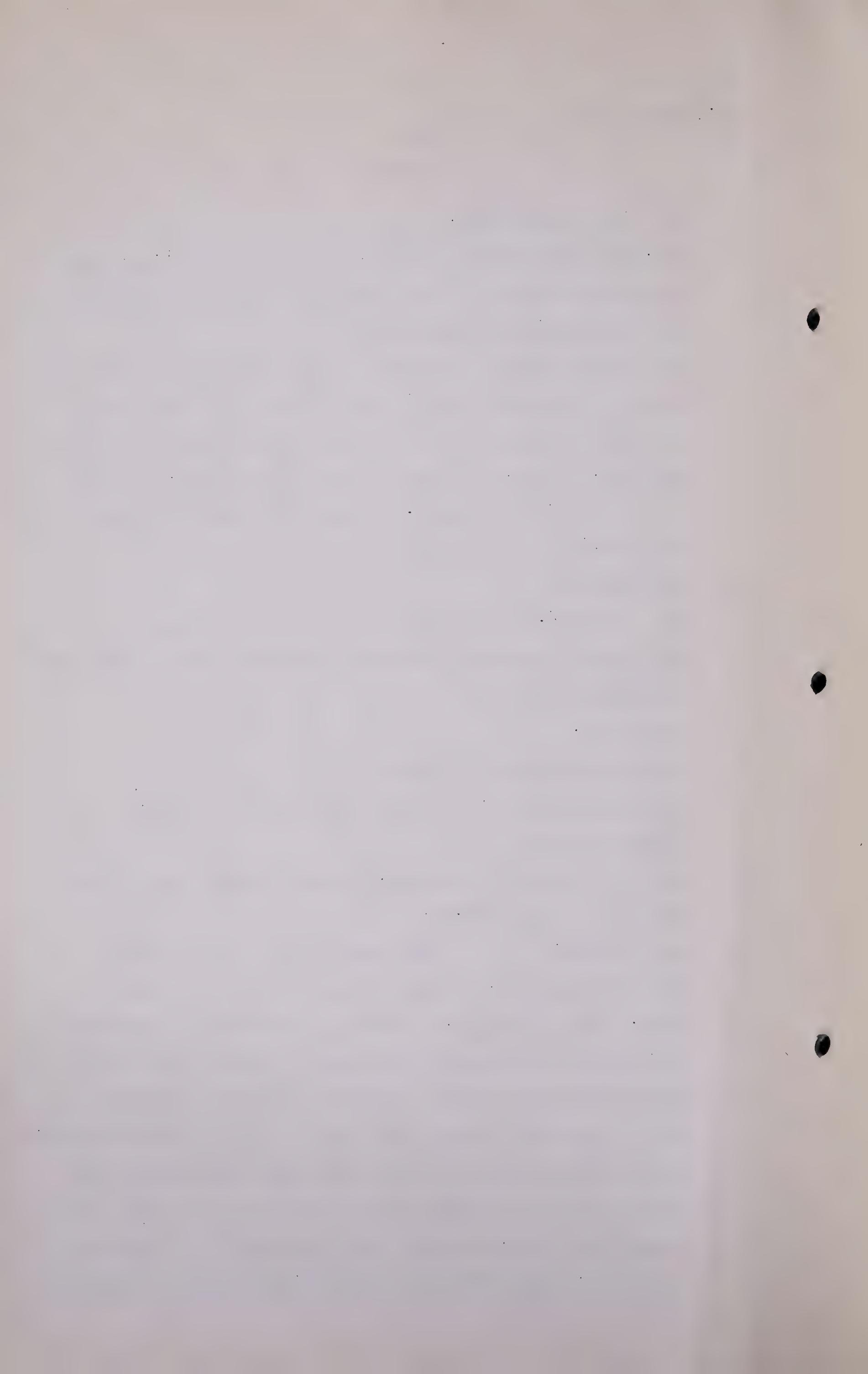
A I put the meters in, I think I have a note of that.

Q I show you M-6?

A That is on page 67 I believe, my new calculation. I have there for meters \$178.00.

Q MR. CHAMBERS: What page are you reading from?

A That is on page 67. There are several ways to figure a meter. You can figure, a meter is composed of a recording gauge which has generally two pens, a pressure pen and a differential pen and the orifice flanges and an orifice with a connection between that orifice plate and the meter. Now you can figure the orifice with the meter and you can figure the orifice itself and the plate and you get a higher figure than I get, so when I say I used \$178.00 I used the bare meter. My orifice is included in my pipes, valves and



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fittings in the listing, so that there is apparently no basis for an exact comparison between the prices I used for my bare meter and the price which the B.A. has included for their meter because their meter is there, it seems to contain a part of the fittings and the orifice which I put in my meter fitting. All you can take is the total.

Q Well all right. Then your answer with respect to the items under "valves, fittings, meters Etc." in the B.A. account is that part of it is included in your unit costs or construction, or rather in your unit costs for pipe.

A No, not for pipe, for the meter setting.

Q Perhaps you misunderstood me?

A On page, -I can say this perhaps more clearly, in the B.A. statement we have here a price for valves, fittings, meters and so forth.

Q MR. CHAMBERS: On what page is that?

A That is on page 3 and page 4, it totals anyway \$667.97.

MR. HARVIE: I think we must for our purposes, if you will excuse me interrupting, I think Mr. Hill is actually referring to pages 2 and 3 of the B.A. submission, volume 2A, not volume 2.

MR. BLANCHARD: Volume 2A.

THE WITNESS: Pages 3 and 4 are the pages I see here.

Q MR. BLANCHARD: Pages 3 and 4 of volume 2-A?

A Now that price of \$667.97, \$134.34 is included in my price of pipe line.

Q Is included in your price for pipe line?

A Yes.

Q That is what I wanted.

A And the balance is included in my charge for meters, my



Mr. Edgar G. Hill
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price for meters.

Q In your price for meters?

A And meter settings which include....

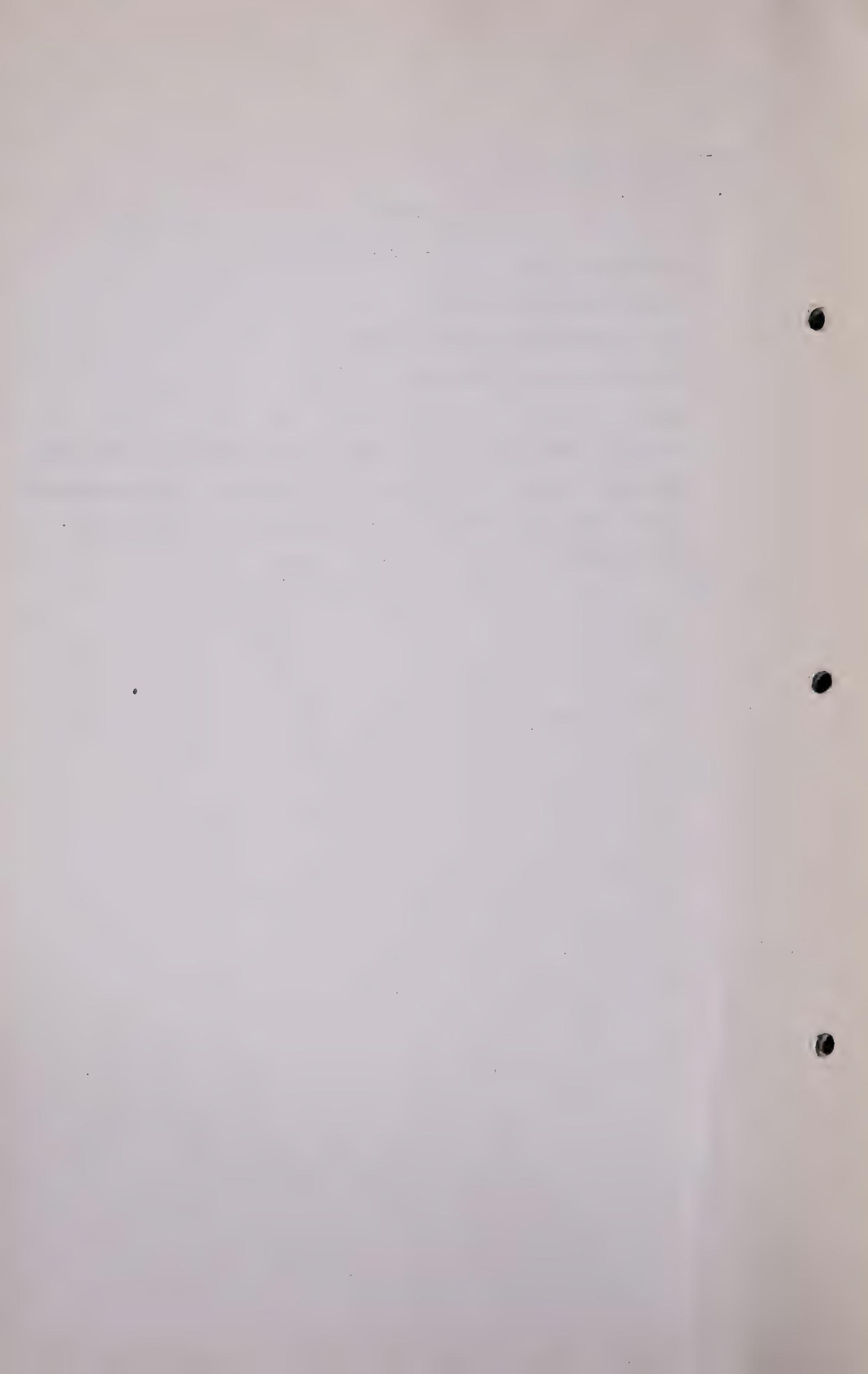
Q As shown on page 67 of M-6?

A Yes.

Q Now then I again refer, and I should not have taken this away from you, I again refer to page 4 of 2A of the B.A. submission and you will see there on page 4 installation costs at so much per foot?

A Yes.

(Go to page 1799)



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Cross-Exam. by Mr. Blanchard.

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Q Then there is another item, connection labour. Now is that item - do you know whether that item connection labour is included in your unit cost?

A It is included in my unit cost of pipe line labour.

Q Now then I just want to be clear about this item of interest during construction. That is included in your 9% general overhead. In charging 3% as part of that general overhead, you are doing so on the assumption that the whole installations are made in the course of one year and at one time. Is that right?

A That is correct.

Q I was wondering why you made such a small charge.

A Because you would not need your money over half the time.

Q And you are charging 6%?

A I am charging 6%.

Q Now you mentioned the fact that the North West Utilities was financed by bond issue largely?

A Largely, yes sir.

Q And the result is that I suppose that as the Utility Company receives its return from the sale of gas and pays these bonds that is something that is not subject to the payment of income tax?

MR. CHAMBERS: I am submitting that this witness does not know.

THE CHAIRMAN: He might know.

Q MR. BLANCHARD: Is that correct?

A In the United States it is correct.

Q But you do not know?

A I would not say all of the interest - part of the interest at least. I do not know what the Canadian law is.



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Q THE CHAIRMAN: Mr. Hill, I am interested in this general overhead cost that you have added. Does that item appear in the Company's books at all?

A No sir.

Q I assume it is an item that you have added because in your opinion as an Engineer it is a proper amount to add to a valuation such as you have made?

A Yes sir.

Q On what base did you arrive at your depreciation. You may have already told us Mr. Hill but if you have I have forgotten. You have written it down to \$173,200.00?

A I arrived at it on the basis of my inspection of the property and my determination of the physical condition of the property.

Q I am speaking of the \$212,100.00 item which you have written down to \$173,200.00?

A I depreciated that in the same percent that I depreciated the physical property.

Q Yes I understand. I had an idea and I may be quite wrong, that expenses of that kind were written off rather quickly by most companies?

A I do not know of any companies that write them off any quicker than they write off their physical depreciation, bond discounts are sometimes amortized over the life of the bonds, but I have not taken that into account in this heading.

Q I am going to ask you a question that you may think is stupid, but keeping in mind that I am merely a lawyer. We have heard about observed depreciation. We have heard about depreciation that is based on life expectancy and we have heard of accrued depreciation as that item appears in the Company's books. I am not altogether satisfied that either one of them is the



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correct measure of depreciation used. Is there any way at all in which those three can be rationalized so that a humble person like myself might arrive at a fair, decent judgment?

A The depreciation that is shown in the Company's books in this particular instance was based on the life estimate - estimated life, or some other arbitrary assumption of 10% depreciation as I understand it which would write off the cost of the property in ten years. That is common practice in the case of all prospecting ventures where the Company needs money for exploration and for developmental work. It takes as large a percentage that a prudently run company would use as large a percentage of annual depreciation as tax laws would permit them to use without any regard to what that course did to its property account because its earnings are not based on its property account and has no reason for keeping its property account intact so I think you should disregard the depreciation now shown on the books of Royalite for this Company's property at the time it was put into the public service as a utility. My observed depreciation in the case of pipe shows what in my opinion the actual facts were physically at the time I made my inspection.

Q I do not want you to repeat that. I understood that.

A I understand that now there are other ways of getting at the depreciation that has existed, that is actually not depreciation. It is amortized, you might say, which has taken place if the Company was a public utility from the start. That is what was done as I recall it in the Valley Pipe Line case. I do not know of any other way in which your Commission can rationally approach that depreciation problem. I think that the Compression Stations, the new Stations have a life of at least - will last as long as they are needed. You can



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corelate those stations with the life of the field. The pipe lines will probably outlast the field physically, but if they do they will have no use except what you can get out of them for salvage. The Scrubbing Plant. I think that the Girbotol part of the Scrubbing Plant with proper care and replacement as necessary will last as long as the field is there. The Seaboard Plant will not - I do not think it will physically and I apprehend it would be put out of service before the Girbotol is put out. Is there anything else to answer your question?

Q I think I have just one more. I suppose that another Engineer going over this plant and trying to arrive at observed depreciation might very well be higher or lower and it would be rather miraculous if you both arrived at the same figure.

A I would be pure happen-chance.

RE-EXAMINED BY MR. CHAMBERS:

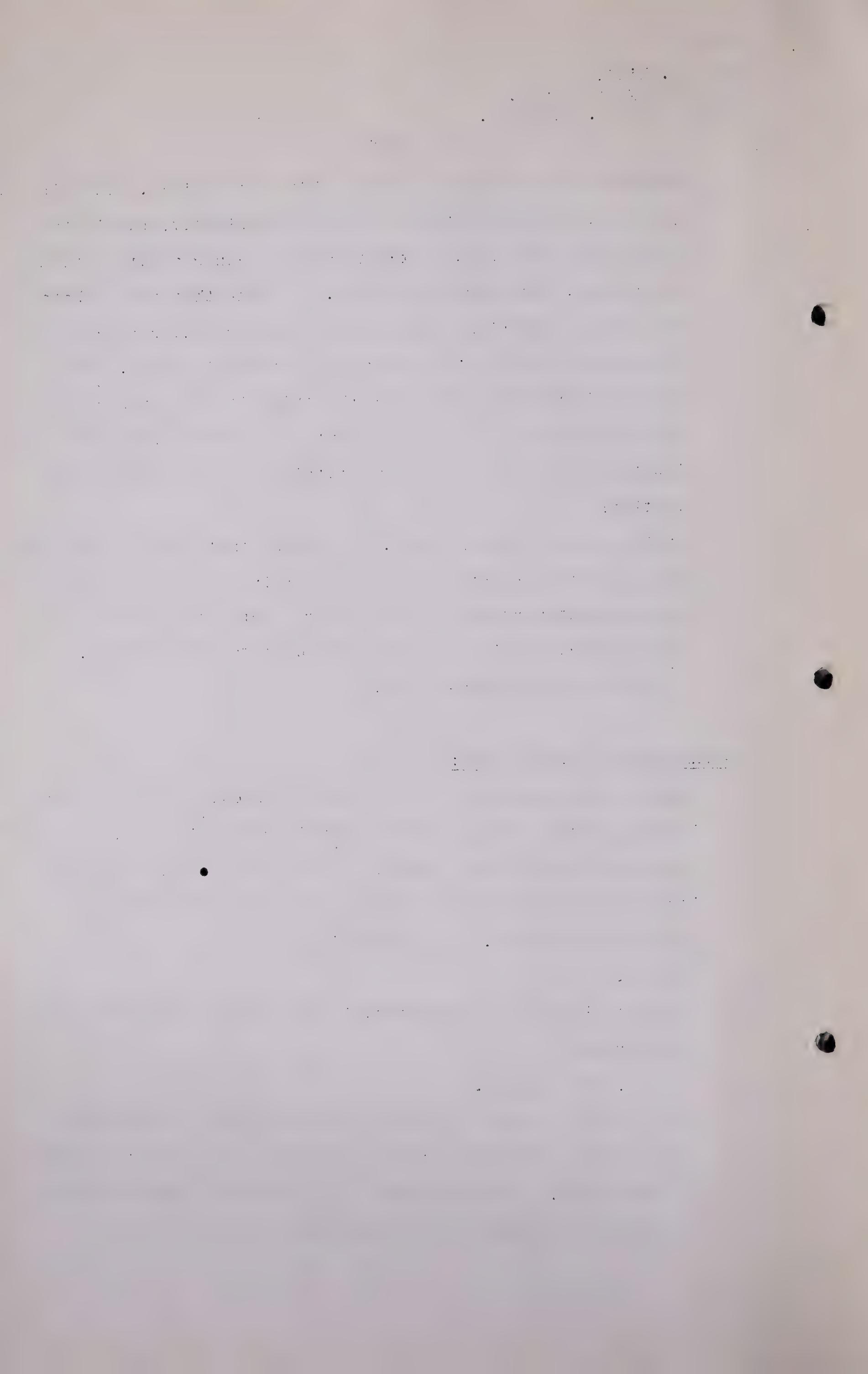
Q There is one question I would like to ask out of the question itself and you said in answer to my learned friend Mr. Blanchard the other day that you thought at this stage of the proceedings 5% would be a fair estimate for salvage in setting up future depreciation. Am I right in that?

A Yes sir.

Q And that figure as I understand it is what you sometimes call net salvage?

A Yes sir, net salvage.

Q And by that is meant a 5% would be recovered by the Company after it has paid the cost of dismantling and marketing what is marketable. In other words it is what the Company would get net after paying the salvage cost. Is that right?



Edgar G. Hill,
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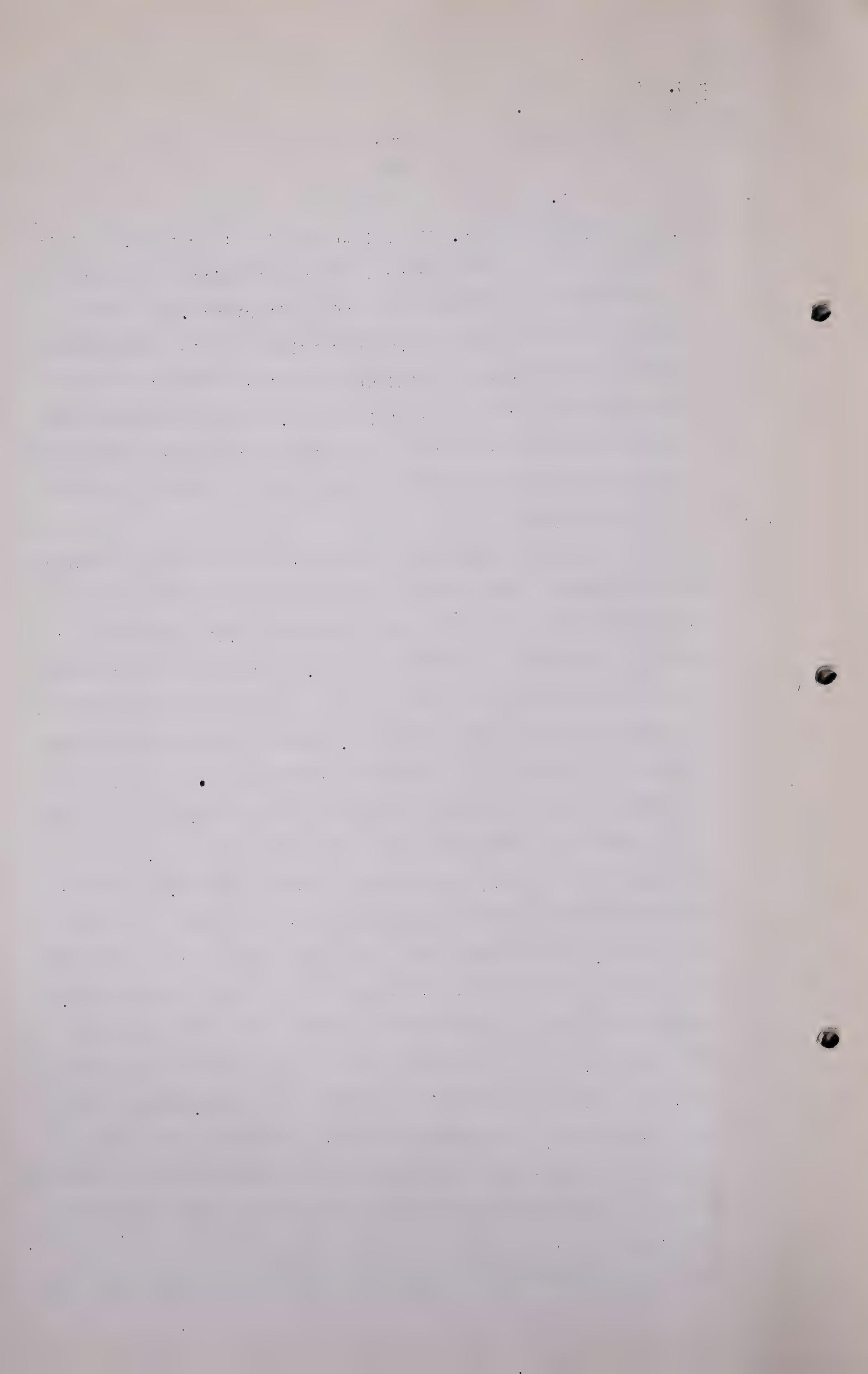
- 1803 -

A That is right.

Q DR. BOOMER: Mr. Hill, I would like to get your opinion on this matter of obsolescence. I am not quite sure that I can get it clearly from the record as it stands. Supposing you have a piece of machinery in service on which you place a price value and then you find another piece of equipment that will do the same job and cost less new. Should you reduce the appraised value of the piece of equipment in use to the value of its replacement?

A I think if you are considering value you must take into account obsolescence and obsolescence is an economic question which involves the net cost to the owner of owning and operating a piece of equipment as against the cost of owning and operating a piece of equipment of another type. Now in my experience in the United States I have never yet known the question of obsolescence to appear as it has here. That is where we have two processes which are rather foreign to the gas business. There are not many gas companies that scrub their gas. We have a process at the time it was put in, the only process, and now we find another process coming along costing less. I do not know about the operating cost but costs less I am assuming, to buy. It seems to me if concept of value is used by the Commission they will have to take obsolescence into account. That is if they determine the value of the Seaboard equipment is less because of later developments they will have to take that into account in valuing Seaboard equipment. In other words if they use the cost concept then obsolescence has nothing to do in their findings, because cost concept takes no account of that.

Q Would it be fair to say assuming obsolescence is practiced that



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the value of a piece of equipment that is obsolete would be written down on the books until the net cost to the operation is the same as if it was a new piece of equipment?

A As I said before if the rate base is fixed of considering value then I think your statement is correct. If it is fixed on a cost basis then I think it should be ignored.

Q You do not in your appraisal take into account obsolescence at all?

A No I do not except in a minor way in the Seaboard plant and it was very minor.

Q And it would appear in your percentage of depreciation?

A That is right.

Q THE CHAIRMAN: That obsolescence Mr. Hill of which you have just been speaking is sometimes called functional depreciation?

A Yes I think it is erroneously called that because obsolescence is purely an economic question. Functional depreciation as I understand it is the ability or lack of ability of a piece of machinery to do what it was bought to do. There is no functional depreciation in the Seaboard plant.

Q But I think that was also applied Mr. Hill, to the consideration of what another piece of machinery can do the same operation for?

A I would consider that to be a part for the consideration of obsolescence.

MR. CHAMBERS: Arising out of these discussions another question has come to me and I am perhaps more or less thinking out loud. Mr. Hill you said to the Board that in dealing with observed depreciation and as applied to functional depreciation of cost you should take obsolescence into account.



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Q Now assume that we apply what is known as a service life method of arriving at the approved depreciation. I suggest to you that this Seaboard plant when it was put in was capable of handling so much gas over its total life, or it was capable of so many years, whichever basis you want to take, and that is we are going to estimate the depreciation to date on a service life proposition, it occurs to me that this so-called obsolescence depreciation should not enter into the picture. What do you say as to that?

A I think it depends on what base the plant is computed on, whether computed on a cost base, and if it is computed on a cost base, I would say you were absolutely right. If it is computed on a reproduction cost new base, which reproduced plant is 20 or 22% higher than the cost, then the obsolescence, if any, I think would enter into the final decision of its depreciated value.

Q That would apply, that would be applying it on present day costs new?

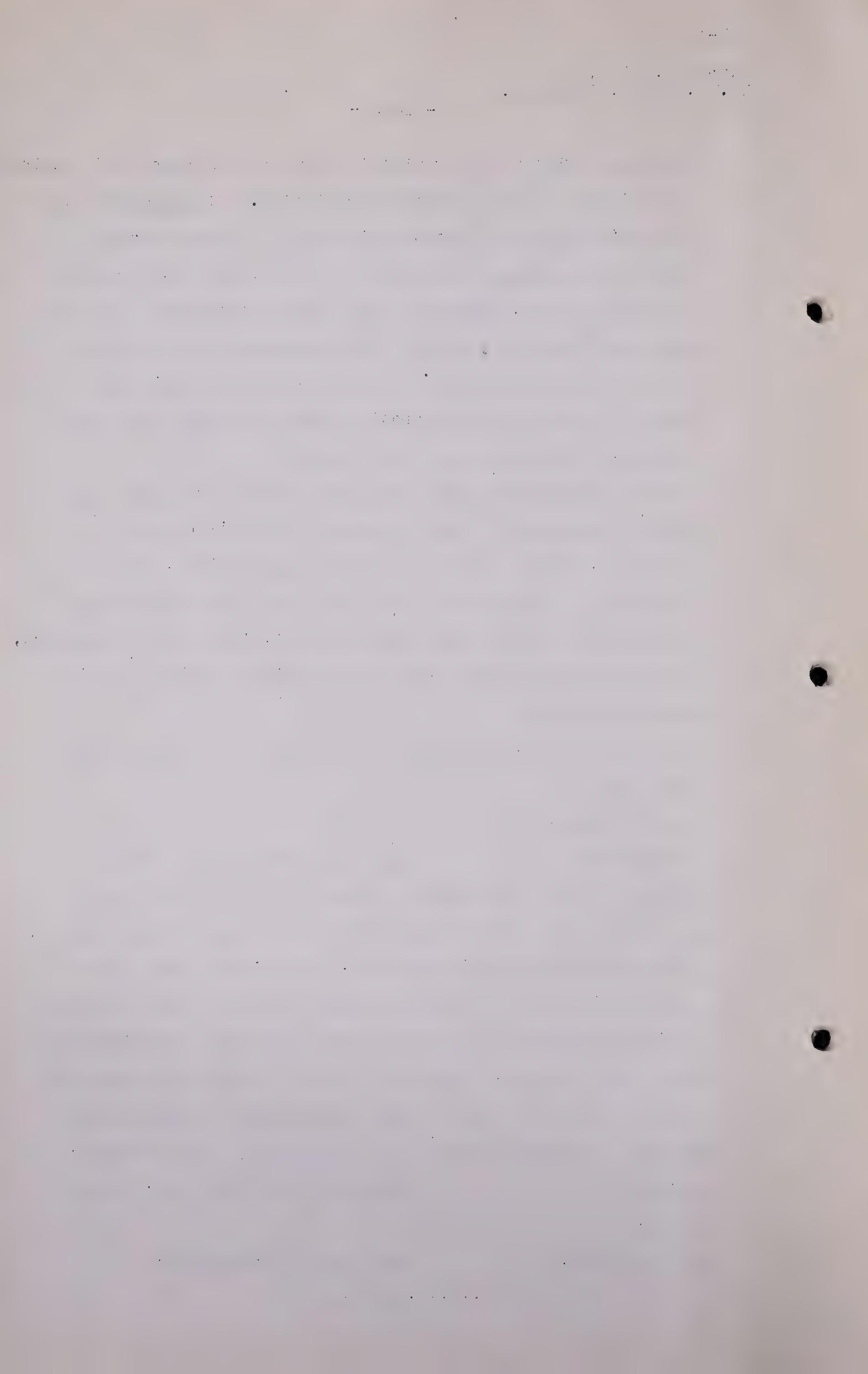
A That is right.

THE CHAIRMAN: Anything further? Mr. Hill, before you leave the witness stand, Dr. Boomer and I want you to know how much we appreciate the assistance you have given us in this particular case. We consider that your evidence is very very valuable, and, above all, we have been delighted with the frankness and the sincerity with which you gave your evidence. We might not agree with you altogether but that does not detract from the pleasure we have had in hearing you and the value which we place on your evidence.

WITNESS: Thank you very much, Mr. Blackstock.

THE CHAIRMAN: All right, Mr. Chambers.

.....



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WILLIAM CLIFFORD KIRKPATRICK, having
been first duly sworn, examined by Mr. Chambers, testified as follows:

Q Your full name is William Clifford Kirkpatrick, is that right?

A Yes sir.

Q And you are the secretary-treasurer of the Madison Natural Gas Company?

A I am.

Q Now, Mr. Kirkpatrick, you were present, and I understand you have made yourself familiar with, I should say you were present when Mr. Hill gave his evidence?

A Yes.

Q And you have examined Exhibits 59 and 60 which are his appraisal reports?

A Yes sir, I have.

Q Now, Madison has, as I understand it, acquired or taken over the property, or at least I want to satisfy the Board that Madison has. Now I would like you to tell us whether that is so and what you know about it?

A Well included in the Madison report M-6, which is Mr. Hill's original appraisal, and that is Exhibit 59, and I believe Madison's number M-6A, which is Exhibit 60, I believe, are the physical assets which Madison acquired from Royalite by agreement.

Q Have you that agreement?

A Yes, I have that with me.

Q And you are referring to an agreement of the 10th day of March, 1944?

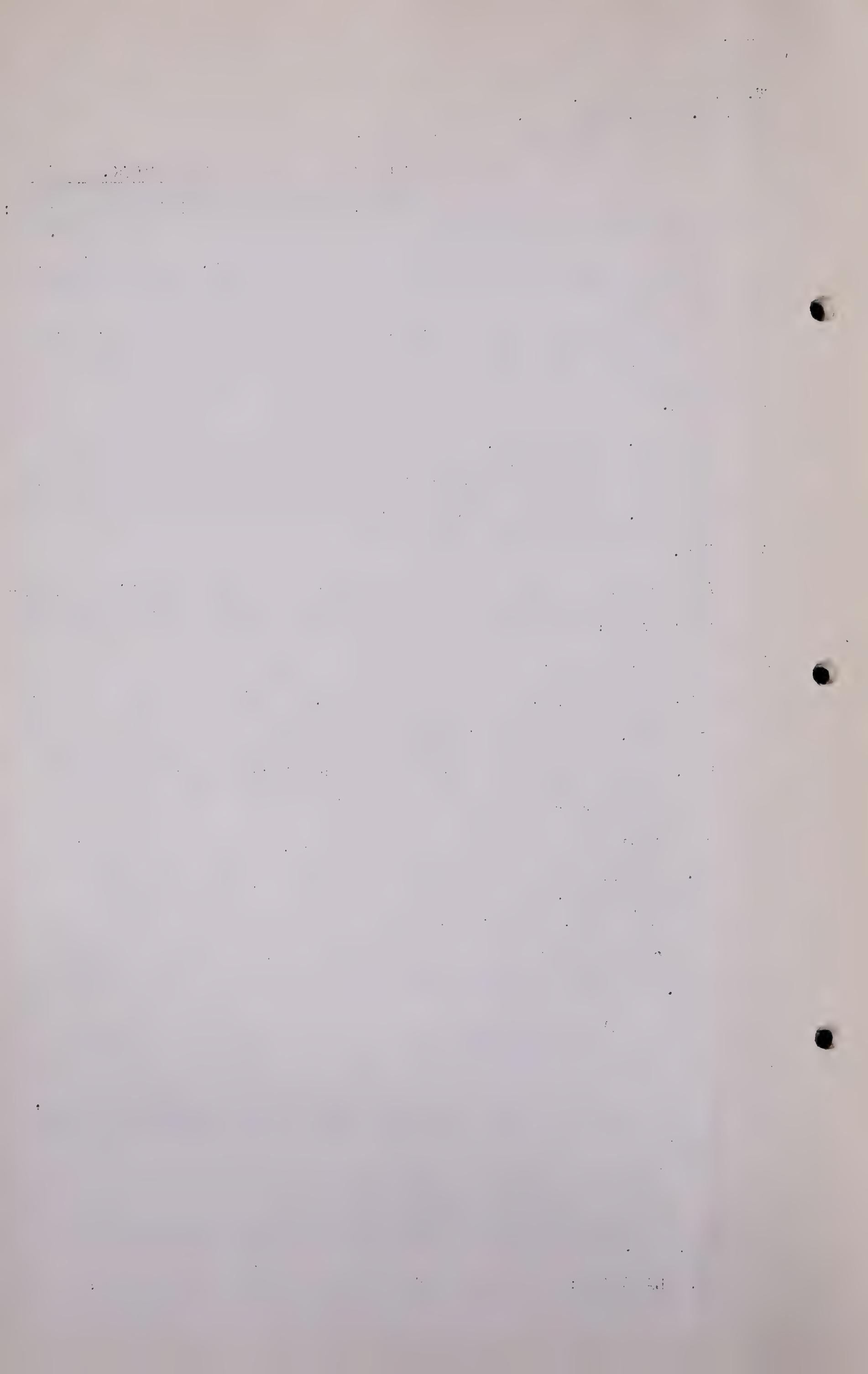
A Yes, I think that is the agreement.

Q Between the Royalite as vendor and Madison as purchaser?

A Yes, sir.

MR. BLANCHARD:

What was the date, Mr. Chambers?



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MR. CHAMBERS: 10th day of March. I suggest to the Board that it should not be necessary to file the original but I will have the original if anybody wants to check it.

THE CHAIRMAN: No, I do not think you should be called on to do that. Have you a copy of it?

MR. CHAMBERS: Yes sir.

THE CHAIRMAN: You have checked the copies and you know they are correct?

WITNESS: They have been read back.

AGREEMENT BETWEEN ROYALITE AND
MADISON NATURAL GAS MARKED
EXHIBIT 68.

MR. CHAMBERS: available. I only have two extra copies of I am ready to distribute them.

THE CHAIRMAN: It is an innocuous document, Mr. Chambers?

MR. CHAMBERS: Yes. Does the Board suggest that the document should be read into the record?

THE CHAIRMAN: I do not think so, Mr. Chambers, unless there is any part of it you feel is important.

MR. CHAMBERS: No, except that I should probably point out for the purposes of the record here that the consideration was 2,899,994 fully paid no par value shares.

Q Now, Mr. Kirkpatrick, what steps have you taken, or has anybody else under the Madison taken to verify the existence of the plant and equipment that has been valued by Mr. Hill and then has been turned over to Madison?

MR. HARVIE: I suppose Mr. Chambers, you mentioned the number of fully paid up shares, I suppose that represents the same number of dollars?

MR. CHAMBERS: No, no valuation at all.

MR. FENERTY: You say no par value shares?



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MR. CHAMBERS: There are 2,899,994 shares at
no nominal par value?

MR. FENERTY: You have to show them at so many
shares at so many dollars and so many no par shares at a price
of so much. If you are a Provincial Company or a Dominion
Company with no par value shares, you will look at it and you
will find that you have the right to sell those shares at a
consideration not exceeding that amount, and that is the only
right you have under your charter. You have to sell those,
so many shares at so many dollars.

THE CHAIRMAN: If you make an allotment, Mr.
Fenerty, does that imply the sale of the shares?

MR. FENERTY: I beg your pardon.

THE CHAIRMAN: If you make an allotment does that
imply the sale of the shares?

MR. FENERTY: The sale of the shares?

THE CHAIRMAN: If you make an allotment?

MR. FENERTY: Yes. What I say with no par shares
the only thing you can do is to sell them at a price not
exceeding your figure mentioned in the charter. That is what
your charter says.

MR. CHAMBERS: I know what the charter says.

MR. FENERTY: That is what the Act says.

MR. CHAMBERS: The Act says for the purpose of
doing business. Surely you can do it on a certain basis?

THE CHAIRMAN: I pass security issues all the time,
Mr. Fenerty, where the promoter gets a million no par value
shares for his property, and there is no mention of prices at
all. Am I doing wrong in doing that?

MR. FENERTY: I am only saying what my interpre-
tation of the law is, and my interpretation of the law is that



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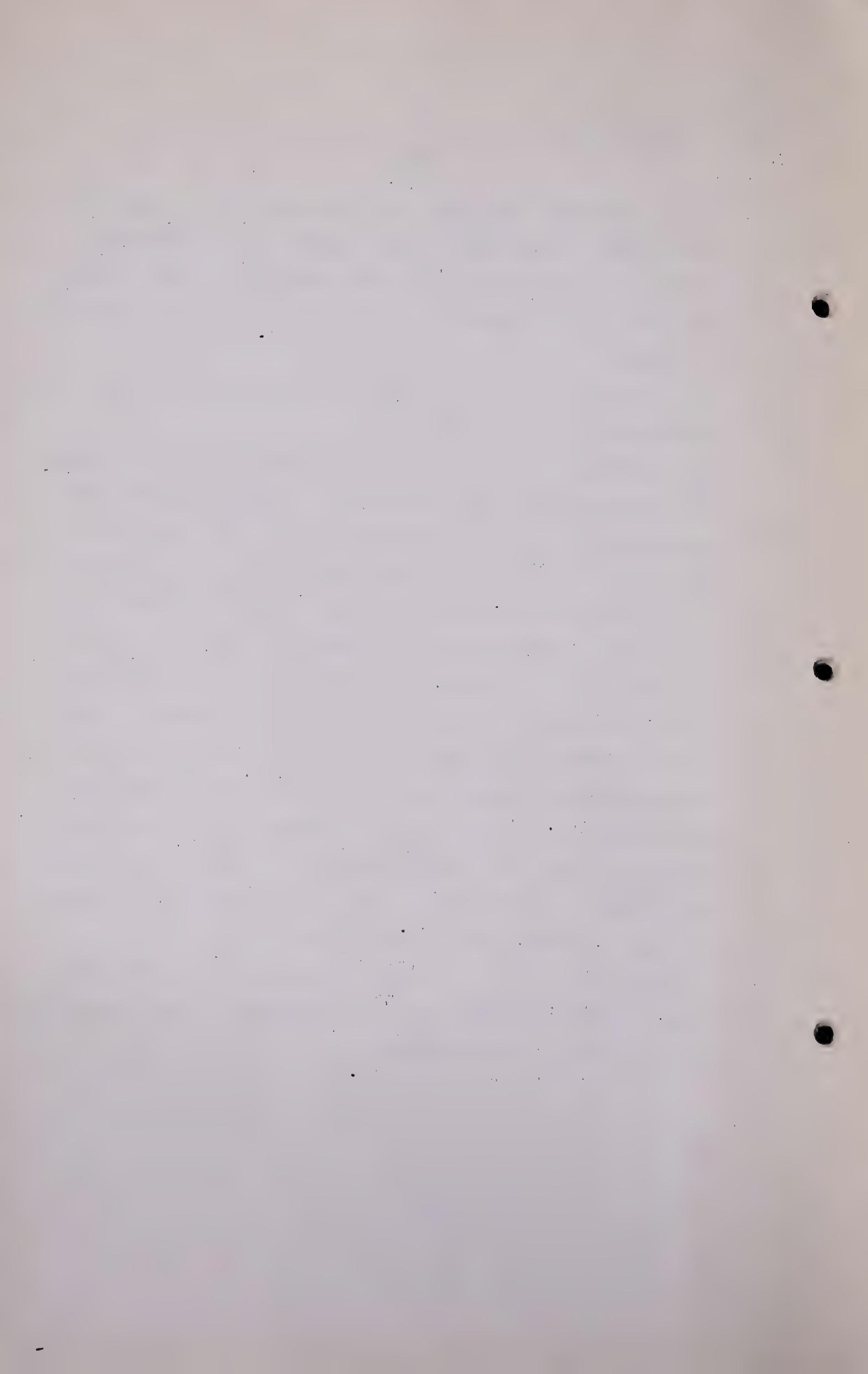
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every no par share that was ever authorized in any company, either under the Dominion or the Alberta Act, is something which may be sold for a price not exceeding a certain amount, and that is the incident of a no par share. However, that is all right.

MR. CHAMBERS: I am prepared to stand by the validity of the agreement.

MR. FENERTY: Just let us take this for a moment. Let us say that you have got now, the difference between the par shares and the no par shares, is that a par share may be issued at a premium. If it is a \$100.00 share you can issue it for \$100.00 or something more, but you cannot issue it at a discount, except by way of a commission, 25% or so. When you come to a no par share you can issue it at any price up to the amount specified, and you pay a registration fee based on the maximum price, which may be \$1.00. Now, this does not mean anything. Suppose those shares are such that you can issue them for a consideration not exceeding \$1.00, and they have been issued for a consideration of 1 cent, then you have got 1/100th of this price. You have not got anything unless you know the amount that they are issued at.

MR. CHAMBERS: Where does the law require me to tell you that? You can look at the charter of the company and you can find the consideration.



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MR. FENERTY: There is no way of setting the price if any of the shares can be issued for anywhere from 1 cent to 100 dollars a share, but not exceeding 100 dollars a share and you issue so many thousand for the company, there is no way of telling whether you have paid 100 times the minimum consideration or not for the company unless you see the amount for which each share was issued. You can issue them from anywhere from a cent up to 100 dollars and the number of shares mean nothing unless you know the amount at which they are issued.

THE CHAIRMAN: I can see the point you are struggling with, Mr. Fenerty, and I know what is in your mind. But if you saw the Board's Order approving of that agreement it might as well have said tuppence-ha'penny or 50 million dollars for all the difference it is going to make in the final result of this case. There is an Order of this Board approving the agreement and it is hedged I hope so carefully I say they might as well have said tuppence-ha'penny or 50 million dollars. Then perhaps we can go on with the witness.

THE WITNESS: What is the question?

Q MR. CHAMBERS: The question is this, do you as secretary of the Madison Company, did the Madison Company satisfy itself that it has gotten the assets and of their existence covered by Mr. Hill's exhibit 59 and 60?

A During the course of the calendar year 1944, the early part of the year, or commencing the early part of the year, arrangements were made to have an inventory of the physical plant and equipment which is included in Exhibit 59 verified with the equipment in existence and used in the field. The above-surface equipment such as buildings, pumps, bunk-houses, buildings, automotive equipment, boilers, etc. were verified as to their existence as against the contents of Exhibit 59. Not all



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of that was done by visual inspection by people from the Calgary office but the bulk of it was. Equipment located in rather isolated parts of the field, such as heaters and boilers, were checked in the main by contact with field personnel familiar with their existence and use. As to pipeline footage and sizes contained in Exhibit 59, they were tied in with field engineering maps prepared by Madison's staff. Arising out of that inventory, which I do not submit is 100 per cent checked but is substantially so, is the statement M-6A marked Exhibit 60. I say not 100 per cent checked because every little fitting and valve has not yet been checked has not been possible to do so. But we are generally satisfied of the existence and use of that equipment.

Q MR. Kirkpatrick, it was a result of your check that it was necessary for Mr. Hill to prepare his Exhibit 60?

A That is exactly the reason it was prepared. I might say too, Mr. Chambers, that the existence of the materials and supplies has been verified on three separate occasions by actual count.

Q MR. BLANCHARD: That is the item under working capital?

A Yes, sir.

Q MR. CHAMBERS: Pursuant to Exhibit 68 which was the general agreement between the two companies, there was an assignment of certain contracts by Royalite to Madison. One was the Gas Company contract was it not?

A Yes, sir.

Q We have several copies of that.

A Yes, you want both the assignment and the contract proper.

MR. CHAMBERS: I think it would be as well to put them in as one Exhibit.



W. C. Kirkpatrick,
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THE CHAIRMAN: I think so.

DOCUMENTS IN QUESTION
NOW MARKED EXHIBIT 69.

MR. CHAMBERS: Exhibit 69 consists of an assignment dated the 20th day of March, 1944 from the Royalite Oil Company Limited to Madison Natural Gas Company Limited and the Canadian Western Natural Gas, Light, Heat & Power Company Limited and attached to the assignment and forming part of the Exhibit are three agreements. There is an agreement dated the 10th day of July, 1925 between the Royalite Company and the Canadian Natural Gas, Light, Heat & Power Company Limited; another agreement dated the 27th day of June, 1924 between the United Natural Gas Development Company and the Canadian Western Natural Gas, Light, Heat & Power Company Limited and a third agreement dated 21st December, 1921 between Royalite Oil Company Limited and Canadian Western Natural Gas, Light, Heat & Power Company Limited. I take it the Board does not want us to read the contracts into the record?

THE CHAIRMAN: No. There are two there that perhaps you can tell us briefly the purpose of. First, Mr. Chambers, I refer to the agreement of the 27th of June, 1924 between United Natural Gas Development Company and the Gas Company.

MR. CHAMBERS: The main agreement is the one of the 10th of July, 1925. They are really supplementary to and making changes in the prior contract. The final agreement is really the one of the 10th of July, 1925 because it incorporates certain other provisions in it.

THE CHAIRMAN: It is the one that governs today?

MR. CHAMBERS: Yes. Well I think the final agreement mentioned a rate of 10 cents.

A Nine cents. Ten cents and nine cents.



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Q And that amount was changed, lowered.

THE CHAIRMAN: Have you any more copies of that?

A I can get some. I can give you mine if we are not going to discuss it.

Q In the meantime you can keep it and we can get it from you when we are through.

MR. CHAMBERS: I do not propose to discuss the contracts. I mean they speak for themselves and I am just wanting to show through Mr. Kirkpatrick and get on the record that Madison now has them in place of Royalite.

Q Then, Mr. Kirkpatrick, there was certain correspondence between the two companies early in 1944 which dealt with the supplying - have you those letters?

A You are referring to the arrangement between Royalite and Madison for the acquisition of gas?

Q Yes.

A Yes.

DOCUMENTS IN QUESTION
NOW MARKED EXHIBIT 70.

Q Just tell us briefly, Mr. Kirkpatrick. There are two letters one dated February 3rd, 1944 from Madison Natural Gas Company Limited to J. H. McLeod of the Royalite Oil Company Limited and Mr. McLeod's reply on behalf of Royalite to Madison dated the 7th day of February, 1944. Would you just tell us briefly what those letters contain?

A Under the agreement of March 10th, 1944, Royalite undertook to transfer to Madison all the contracts and agreements and the rights involving the acquisition and purchase of gas from the producers and also the Canadian Western contract under which the sale of the gas was made. However, as it was fore-



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seen that it would be some considerable time before we could make the formal transfer of the numerous producers' agreements which Royalite had in existence at that time and furthermore it was contemplated that possibly there would be some required changes in the producers' contracts as it became necessary to transfer the formal assignments of the producers' contracts and these letters undertake to set forth the arrangements under which Madison would acquire the gas from the Royalite under the Royalite's then existing producers' contracts. In other words

Q. It was an exchange of letters to outline the arrangements until such time as other arrangements could be completed?

A. Yes.

Q. In other words, rather than enter into a specific assignment of all these producers' contracts the matter was covered in correspondence, Exhibit 70, until the whole question of the contracts was finally disposed of?

A. Yes. That was the whole intention.

Q. And there has been prepared and is contained in Madison's submissions which have been filed with the Board, a form of proposed contract?

A. Yes, Madison's report M-16 shows a draft proposed contract which we hope to discuss.

Q. Then Royalite formerly had a contract with or supplied gas to the Valley Gas Company? I understand Madison has taken over that contract.

A. Yes sir.

Q. Have you got the document in that connection?

A. Yes, sir.



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Q Exhibit 71 consists first of all of an assignment dated the 11th day of August, 1944 between Royalite Oil Company Limited Madison Natural Gas Company Limited and Valley Gas Company Limited and attached to that assignment is the agreement referred to in the assignment itself, being the agreement dated the 20th day of March, 1940 between Royalite and Valley Gas Company Limited and attached to that again is a letter of the 28th day of December, 1943 from Mr. Heard on behalf of the Royalite Oil Company Limited to the Valley Gas Company Limited and a further letter dated the 29th of December, 1943 from Valley Gas Company Limited to Royalite Oil Company Limited. In other words, Mr. Kirkpatrick, as I understand it this Exhibit 71 sets out the arrangements under which you are dealing with the Valley Gas Company Limited.

A That is correct.

Q Mr. Kirkpatrick, in addition to these physical assets, plant and equipment that Madison acquired from Royalite, I understand you got certain cash and stock in trade. You can tell us about that?

A Well we acquired a total of \$100,000. in cash and in addition to that That was the cash working capital which it was estimated the Company would require to operate on its own. In addition to that, we acquired approximately \$65,000., \$65,700. in materials and supplies of a maintenance and operating character which were on January 1st, 1944 physically in position in the Turner Valley warehouses. In addition to that there were through normal operations equipment of a non-capital nature, operating and maintenance equipment on order and in transit to those warehouses and those were diverted to Madison but not paid for by Madison since they were



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not on January 1st, 1944 available in the warehouses but were in transit. The total effect of the initial volume of materials taken over on January 1st, plus what was received during the year as a result of orders pending, amounts to approximately \$93,000. I beg pardon, The figure is somewhat higher than that but of that total we have identified \$93,000 as materials and supplies of an operating and a maintenance character.

Q That were taken over by Madison from Royalite?

A They were taken over at the beginning of the operation or were subsequently received since these materials were then in transit.

Q In additon you say they got, Madison got from Royalite \$100,000. in cash?

A That is correct.

Q And am I right in this, that Mr. Hamilton, the Board's auditor, has familiarized himself with these details more or less

A I do not know to what extent Mr. Hamilton has gone. But I know we gave him everything he presumably required.

Q I do not want to go into this in detail because I take it Mr. Hamilton, the Board's auditor, has satisfied himself or will satisfy himself.

A I know his examination has been exhaustive but I cannot say whether he has been satisfied or not.

Q Let me put it this way. He has inquired about it and made certain checks?

A Yes, sir, he has.

Q Mr. Kirkpatrick, on page 1654 of Volume 21, Mr. Steer questioned Mr. Hill about a truck that was worn out and replaced in 1944. Mr. Blanchard, on page 1704 of Volume 22, deals with the same matter. I wonder if you would tell us about this



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worn out truck, so called.

A Well I think some confusion has arisen and I think it was in Mr. Steer's and Mr. Blanchard's minds that one of the units originally taken over had been worn out and scrapped or otherwise disposed of and a new unit acquired as a replacement of it in 1944. That is not exactly the case although I believe the confusion arises through the fact that in Madison report M-8, which has not yet been submitted, reference was made on page 9 under the caption Estimate 23 - I might say that this report M-8 is in explanation from an operating standpoint of the reasons and necessity for the equipment that was acquired. Mr. Stevens-Guille's report sets forth that this half-ton truck was in normal replacement of a unit which had become worn out in service. Unfortunately that is not quite right. It was a direct replacement - I beg pardon, a direct addition to the existing vehicles. The older unit was not turned in or disposed of and it is still in operation.

Q Now am I right in this, that Madison now owns and uses the four trucks that are described on page 68 of Exhibit 59 and in addition it now owns and uses an additional half-ton truck which it bought itself in 1944.

A Yes, sir, we have the four trucks listed on page 68 of Exhibit 59 and in addition thereto we acquired in 1944 another half-ton truck.

Q Now on pages 45 and 54 of Exhibit 59, which is Mr. Hill's report and again on page 7 of Exhibit 60 which is his supplementary report Mr. Hill dealt with that Girbotol royalty payment, and for the purposes of the record rather than for the purposes of my question, I am giving the places where it is also referred to, that is on page 1579 of Volume 20, it is



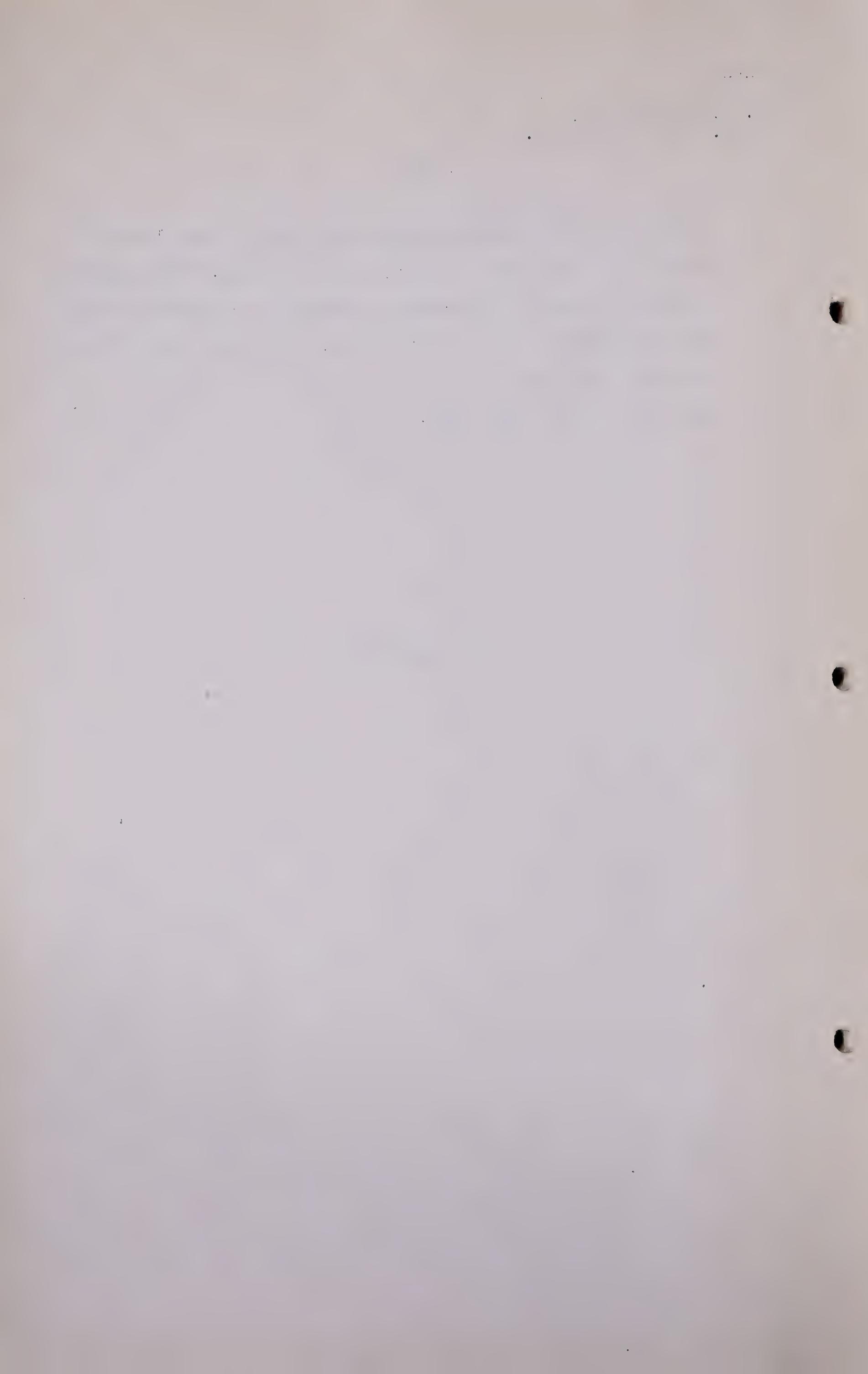
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dealt with again in cross-examination and on page 1658 of volume 21. There was a question as to how Mr. Hill included a certain amount in his valuation for the pre-payment of the Girbotol license. Now first of all, have you a copy of that Girbotol agreement?

A Yes, sir, I have that here.

(Go to page 1819)



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(Document produced by Witness)

MR. CHAMBERS: This might be Exhibit 72 then.

DOCUMENT PRODUCED HERE
MARKED AS EXHIBIT 72.

Q MR. CHAMBERS: And you have the assignment of that?

A That is attached to it, Mr. Chambers. The assignment should be right on the top of your copy, the assignment proper comprises the first four pages, four or five pages of that Exhibit.

Q That is the Girbotol agreement or licence, plus the assignment from Royalite to Madison dated the first of January 1944.

A The assignment is as of the first day of January 1944. The original licence agreement is the first day of December 1941 and the supplemental agreement dated the 31st day of October 1942, they all comprise Exhibit 72.

Q Perhaps just for the purposes of the record, rather than having to read all this agreement into the record, the Girbotol licence agreement is dated the first of December by 1941, granted/the Girdler Corporation, to Royalite and it recites that Girdler is the owner of letters patent granted by the Dominion of Canada on the 8th of December 1931, - and that date will be of some importance later on as will appear by Mr. Kirkpatrick's evidence.

Then by clause 2 of the licence agreement the Girdler Company grants for the life of the agreement a licence which in effect is for the life of the patent and any extentions of it and the limit of the licence is not to exceed ten million, is that M.C.F?



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A S.C.F., standard cubic feet.

Q Every twenty-four hours containing not more than a thousand grains of hydrogen sulphide per one hundred S.C.F.

Then clause 3 says the agreement will run to the full end of the term of the aforesaid letters patent or any re-issue or extention thereof.

And then in clause 4, for the right and licence herein granted the licensee shall pay and hereby agrees to pay to Girdler, subject to the provisions of article 14 within thirty days, \$25,000.00, within thirty days after the plant has been placed in commercial operation.

THE WITNESS: That is U.S. dollars, United States dollars.

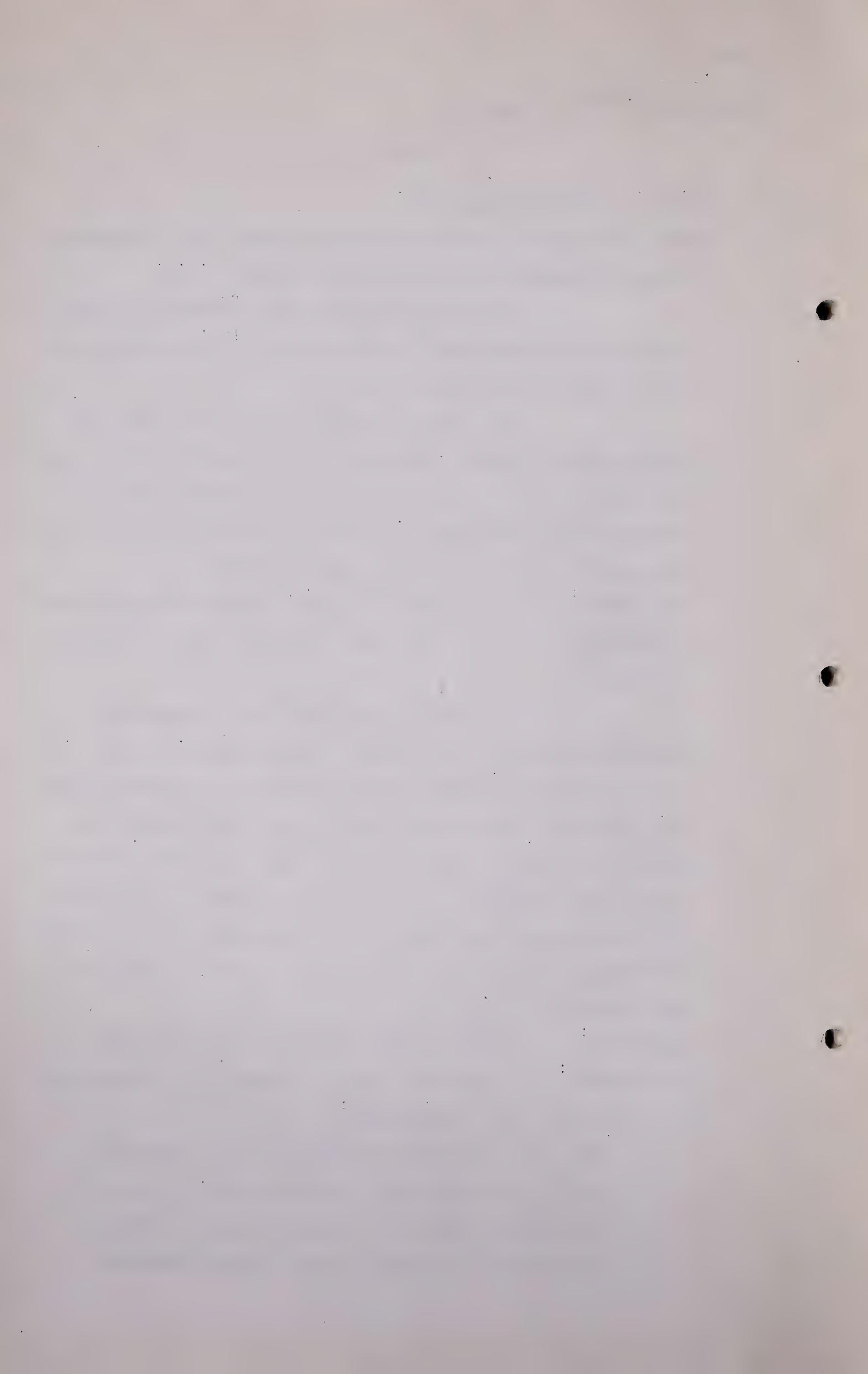
Q MR. CHAMBERS: Yes. Then I do not think there is anything in clause 5.

The next clause is 6 that I suggest is important and that in effect as I understand it, says when the Company uses or processes more than this ten million per day, they pay an additional fee to the Girdler people and they may do it in either one of two ways, either "A" or "B" and as I understand it, "A" provides on a monthly basis and "B" is in effect, may obtain it in a capital amount. I have not frankly gone over the agreement in detail but that is my understanding of it.

MR. HARVIE: Does it give the amount per thousand?

MR. CHAMBERS: Yes, that will be clause "A" or paragraph "A" of clause 6 of the agreement:

"Will pay to Girdler on or before the 25th day of the next following calendar month, a Thruput royalty for each one thousand S.C.F. of Natural gas treated in excess of the licenced maximum



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average quantity specified in Article 2 hereof, the amount of said Thruput royalty being determined from part A and C of the following rate schedule in accordance with the hydrogen sulphide content of the gas treated."

It is a quarter of a cent in United States funds, Mr. Harvie, I am told, yes, it appears in clause 4 or on page 4 under "rate schedule", that is .25 of United States dollars.

Mr. Chairman, are we going to take a recess?

THE CHAIRMAN: I would suggest this is a suitable time.

MR. CHAMBERS: Yes, it is for me.

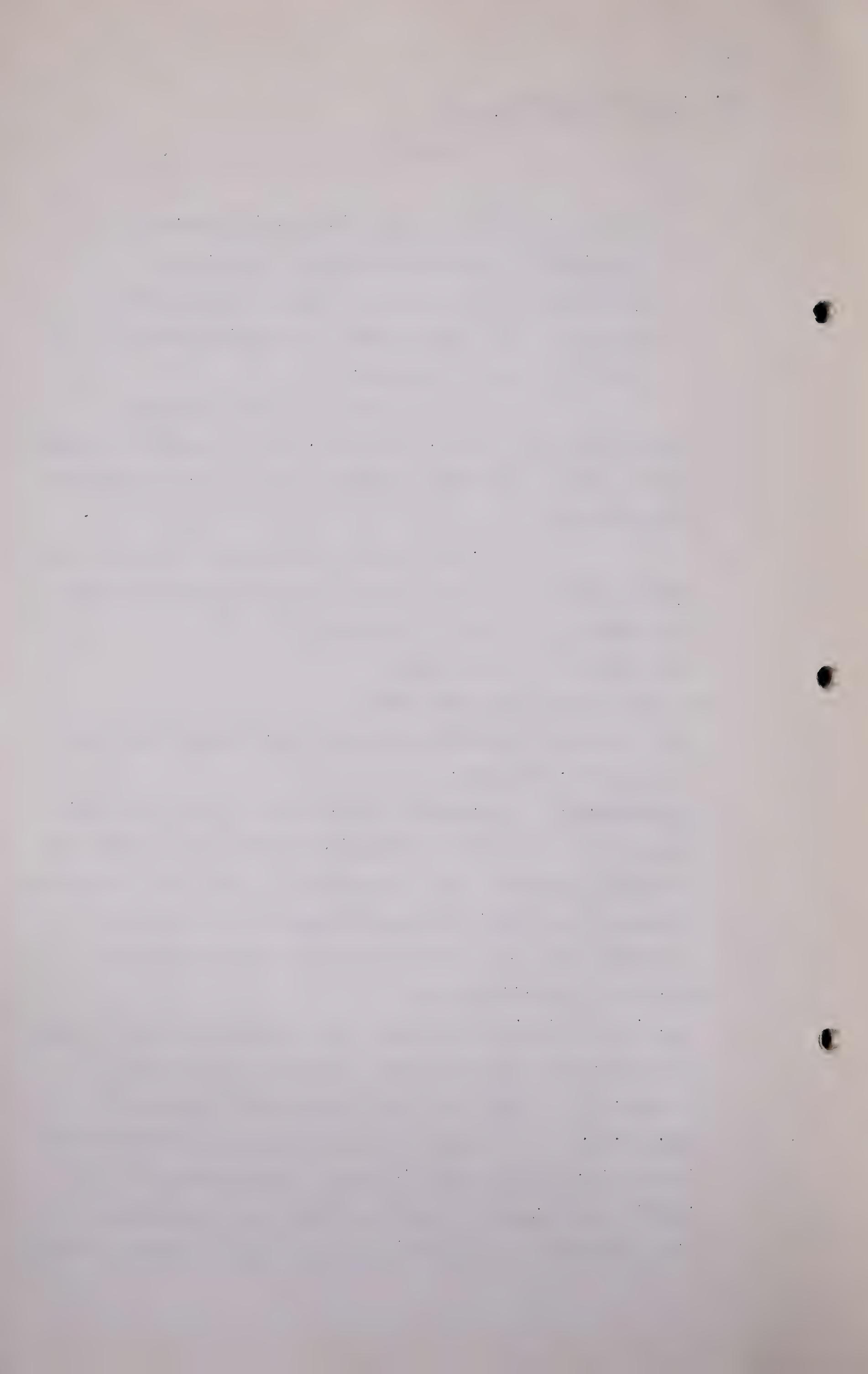
THE CHAIRMAN: All right.

(A short recess was here taken)

(After recess) Direct-Examination of Mr. Kirkpatrick continued by Mr. Chambers.

Q MR. CHAMBERS: Mr. Kirkpatrick, when we rose I was just going to the matter of the amount of \$19,726.00 I think was the amount which Mr. Hill included in his valuation as adjusted by Exhibit 60, being the prepaid amount of the Girbotol royalties, would you please tell us how that amount of \$19,726.00 was arrived at?

A Yes, in Mr. Hill's Exhibit 59, that is the report M-6 at pages 45 and 54, an amount was shown under the "New" column of \$27,500.00 and under the "less depreciation" column of \$25,300.00. At the time that we conducted the examinations which I referred to earlier, namely, the checking of the report, we discovered that that amount was incorrect and we drew it to Mr. Hill's attention, as a result of which he made



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an adjustment in his report, M-6 "A" at page 7, that is a downward adjustment of \$7,774.00 in the "new" column and \$5, 574.00 in the "less depreciation" column and the net then of those two figures is \$19,726.00 recited in both the "new" and the "less depreciation" columns.

Q Now the Royalty, as I understand it, the original cost was \$27,750.00?

A That was the original cost.

Q In American funds, that is what it cost in Canadian funds to produce the \$25,000.00 in American funds, is that right?

A Yes.

Q Now how did they arrive at that amount of \$8,024.00, to bring it down to the \$19,726.00 as at January 1944?

A Well it was arrived at in the following manner; from the Girdler licence, which has been marked as an exhibit, I have forgotten the number, the date of the original....

Q Exhibit 72?

A Exhibit 72, the date of the original letters patent granted was December 8th, 1931. The date, - we assumed then that it would have a life of seventeen years from that date, that is the letters patent would expire on December 8th, 1948. Royalite acquired this licence on December 1st, 1941 so that it had something in the neighborhood of seven years to run. However it happened that in the month of December a relatively small insignificant amount of gas was processed or purified through the Girbotol system so for practical accounting purposes the life of the patent was assumed to be for amortization over a period of eighty-three months, that is computed as the period between January 1st, 1942 to November 30th, 1943.

Q Until the expiration of the Girdler patent?



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A Well within seven days and for practical purposes we ignored that. That gave an amortization rate per month of \$334.34. That came within some twenty odd cents of the actual amount. Since Royalite has had the use of this licence for two years or twenty-four months, it had amortized twenty-four times \$334.34, or a total of \$8,024.16, which deducted from the initial payment or the original payment of \$27,750.00, arrived at \$19,726.00, which Mr. Hill's figure now comes to.

Q In other words the \$19,726.00 included /Mr. Hill's valuation is arrived at by taking the original payment of \$27,750.00 and deducting 24/83's?

A Correct.

Q Which worked ^{out} at \$8,024.00, which you deducted?

A Yes.

Q Which was used up while Royalite was enjoying the patent?

A That is right.

Q Now there were some remarks made the other day as to why Royalite should get that amount of money from Madison, or the right to charge it up to the consumers and get a rate of return on it. Now explain that, Mr. Kirkpatrick, have you done some computations in that regard?

THE CHAIRMAN: I think the real question which came up was whether it should be treated as an operating charge or a capital charge.

MR. CHAMBERS: Yes, and I say that that is the reason I had Mr. Kirkpatrick do some figuring and he has prepared a statement.

THE WITNESS: Yes I have.

MR. CHAMBERS: And what do you call this statement?

A Well it is broken down into two parts, - the first part is the



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reconciliation between Mr. Hill and the formula which was used to arrive at that, that is just what we have just spoken of, and the second part is a comparison of the costs between the Thruput Royalty basis and the prepaid royalty basis.

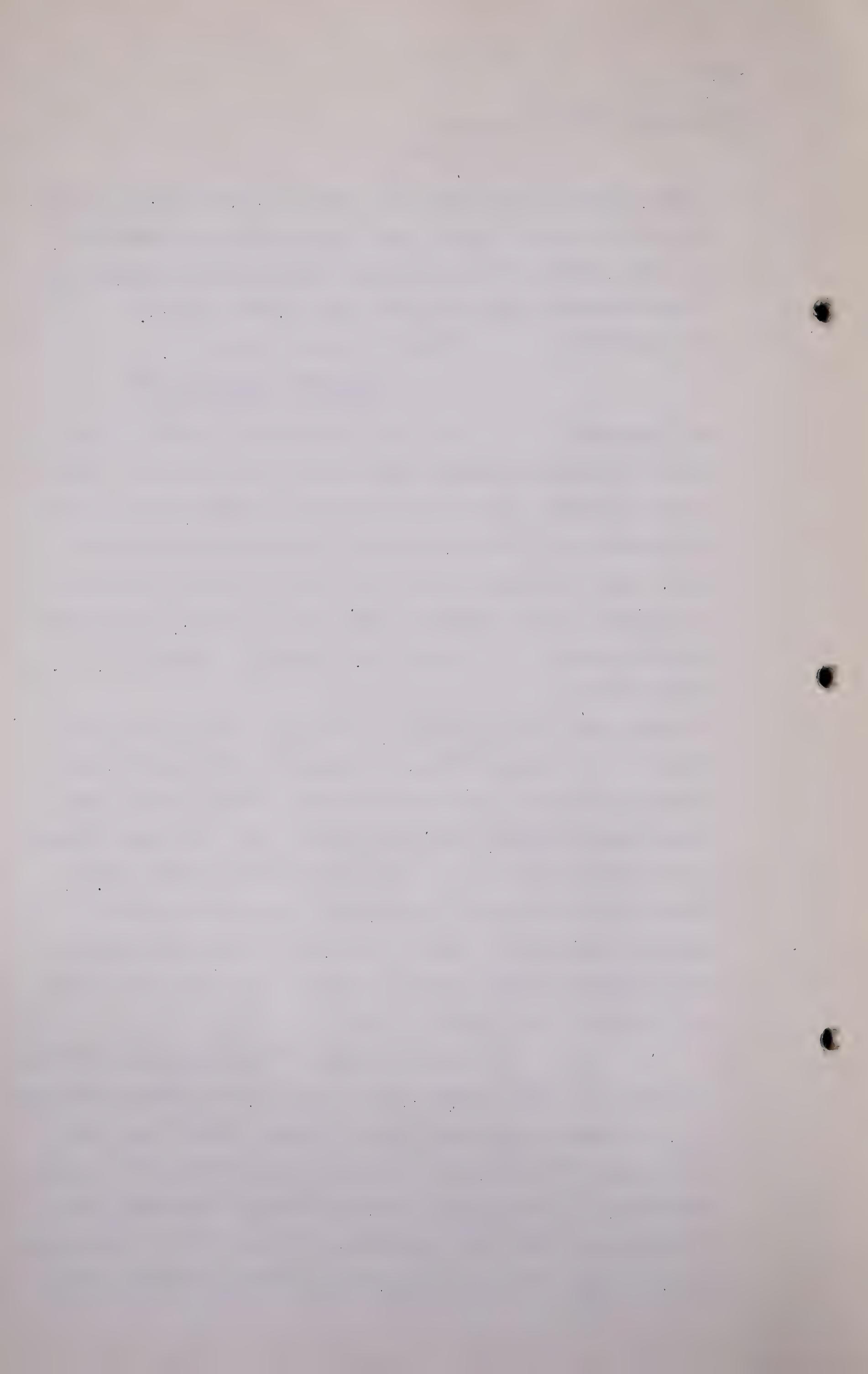
MR. CHAMBERS: I tender that as Exhibit 73.

STATEMENT PRODUCED HERE
MARKED AS EXHIBIT 73.

MR. CHAMBERS: Now I may say for the purposes of the record that my submission would be that in view of the terms of the contract, which includes capital payment, there is an alternative but I am going on the assumption that Royalite could have negotiated a contract in a different way, just on a straight Thruput basis and that this, I submit, would have been the result. Now would you go ahead and explain it, Mr. Kirkpatrick?

A I would like to explain first, that the first part of this exhibit is a reconciliation, the figures which I gave just a moment ago and to the net result of \$19,726.00 I have added, first, the 9% general overhead that Mr. Hill has given further particulars on before, to arrive at a figure of \$21,501.00, which is the value as at January 1st, 1944 taken over by Madison from Royalite and we believe is the amount subject to amortization for the remaining life of the licence or a total of 59/83's of the original licence.

At the lower part of the first page of this exhibit is a table headed "comparison of costs between straight Thruput Royalty basis and prepaid Royalty basis." and this table shows the effects of amortizing the \$21,501.00 over the 59 months for the period January 1st, 1944 to November 30th, 1948 on a straight line amortization basis, that is each month bears the same charge regardless of the particular Thruput



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of that month.

The first column is headed "net prepaid royalty" and it will be observed that we start off with \$21,501.00 from which we deduct first of all fifty percent of the current annual amortization, to arrive at the amount which is submitted subject to the rate of return for that year, that is column 3.

Column 4 is the product of multiplying the amount subject to return by the $9\frac{1}{2}\%$ net figure which has been outlined in Madison's other statements.

Then the total of the column 4, \$3,058.00 is added to the total of column 5, column 5 being the total amortization for the year, to give the total in the extreme right hand column of \$7,431.00 for the first year, \$6,739.00 for the second year, \$6,046.00 for the third year, \$5,354.00 for the fourth year, and \$4,326.00 for the fifth year, or a total for the period of 59 months of \$29,896.00.

That is the basis upon which that prepaid royalty has been amortized and computed in Madison's submission, Madison's report, yet to be submitted.

On page 2 then in order to compare that previous calculation with what might be the alternative basis we have computed the equivalent cost or the alternative cost assuming a straight Thruput royalty of $\frac{1}{4}$ cent and that should read "11 $\frac{1}{4}$ cent United States dollars, per thousand standard cubic feet per day." That computation is arrived at by taking the ten million standard cubic feet, which is the basis of the existing licence, times three hundred and sixty-five days in the year, times $\frac{1}{4}$ cent per thousand cubic feet, which equals \$9,125.00, and that is expressed in terms of U.S. currency at that point, and we have then added to that the exchange



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which would be involved in such a payment at 11% on 85% of the total of \$9,125.00 and 10% on 15% of the said figure, or a total exchange of \$990.07, which gives the total cost per year of \$10,115.07.

I might explain why we used 11% on 85% of the sum payable to Girdler and 10% on 15% of the same. Under the existing regulations of the Dominion Income Tax Department on non-revenue royalties 15% of the royalty is what we deduct and it is payable to the Receiver General of Canada and the 85% of course remaining is purchased at 11% and remitted to the Licensor, hence the 15% which is retained in Canada we convert at 10% rather than at 11%.

Then at the bottom of page 2 is a comparative table by years: The first column headed "cost, prepaid royalty" is merely a transfer of the figures contained in the Exhibit on page 1 and along side of that annual column is the \$10,115.07, which we computed above, except that in the last year 1948 it will be observed that the cost on the Thruput Royalty basis is slightly less and for 11 month period instead of 12.

The results of that show that the cost on the prepaid royalty basis as computed is \$29,896.00, whereas the alternative cost on a straight Thruput royalty basis would be \$49,732.00, or a difference, increasing annually, to a total of \$19,836.00.



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Q So that the \$19,836.00 according to your computation and submission is the amount of savings to the ultimate consumer or to somebody by reason of the flat amount of \$25,000.00 in American funds having been paid in the first instance?

A Yes, that is my opinion.

Q Mr. Kirkpatrick, in Volume 22, Page 1771 or thereabouts, Dr. Boomer questioned Mr. Hill as to the cost of alterations that were made to the Girbotol plant in 1942 and 1943. You have some detailed information on that?

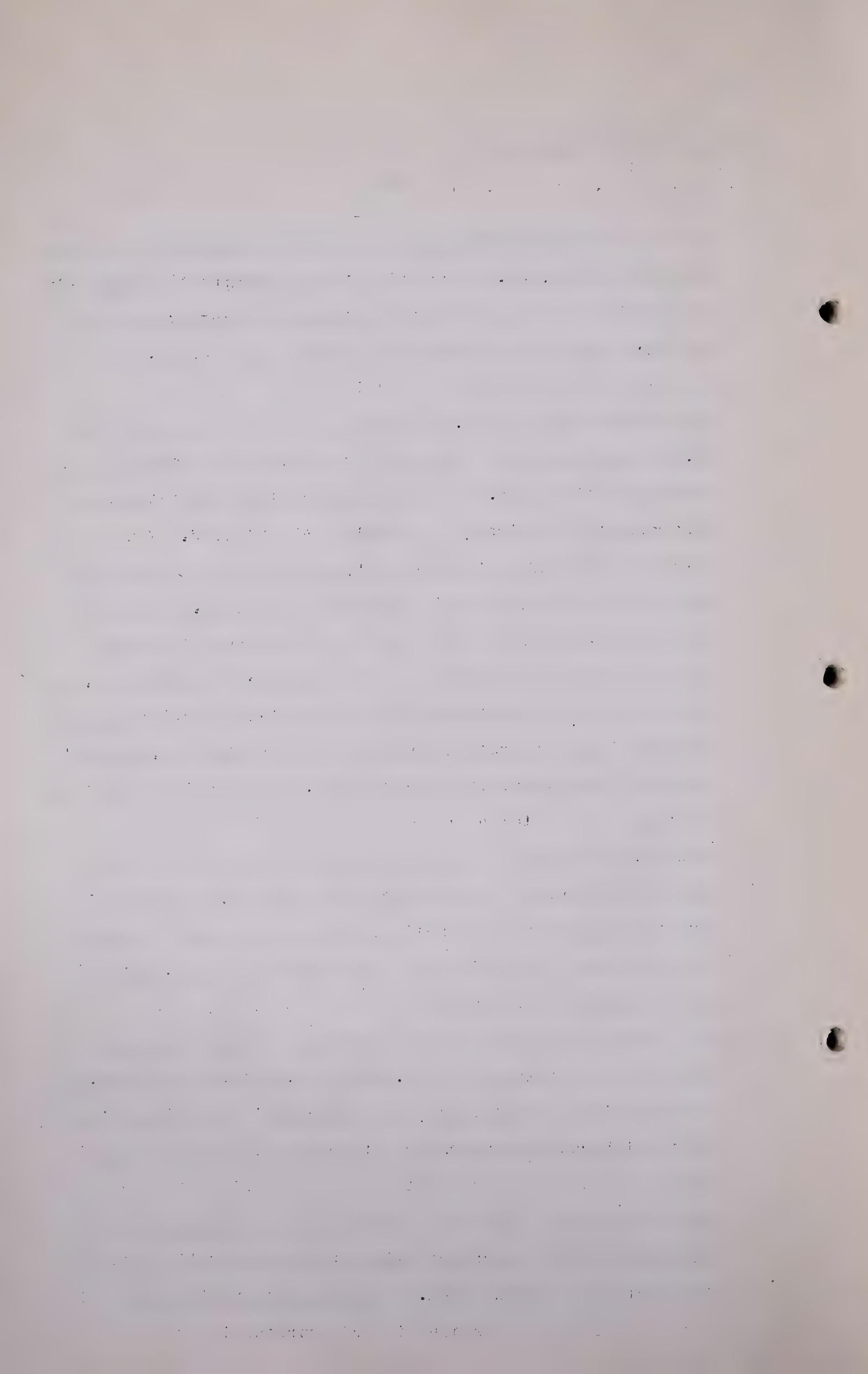
A If I understand the question correctly which Dr. Boomer directed to Mr. Hill, it was related to the conversion of the Girbotol system from a one cycle to a two cycle operation. I am not certain if that is a proper technical description of it, but that is my understanding of it and I believe Dr. Boomer's question had to do as to whether Mr. Hill had included in his values the total cost or any part of the cost of that conversion.

Q Just for the purpose of the record and you probably do not have the first hand information, but from your association with the Company you will probably know that is so. When it was installed in 1941 and 1942 thereabouts, it was supposed to be a brand new process?

A Well I would not know that Mr. Chambers. It was new here.

Q And after it was installed there were certain experimentations on it which caused some changes to be made. Now I would like you to tell us about the cost of those and where they came from?

A I have some notes which were given to me by Royalite and I will just have to find them. The information given to me is that the work which was done in 1942 substantially and I



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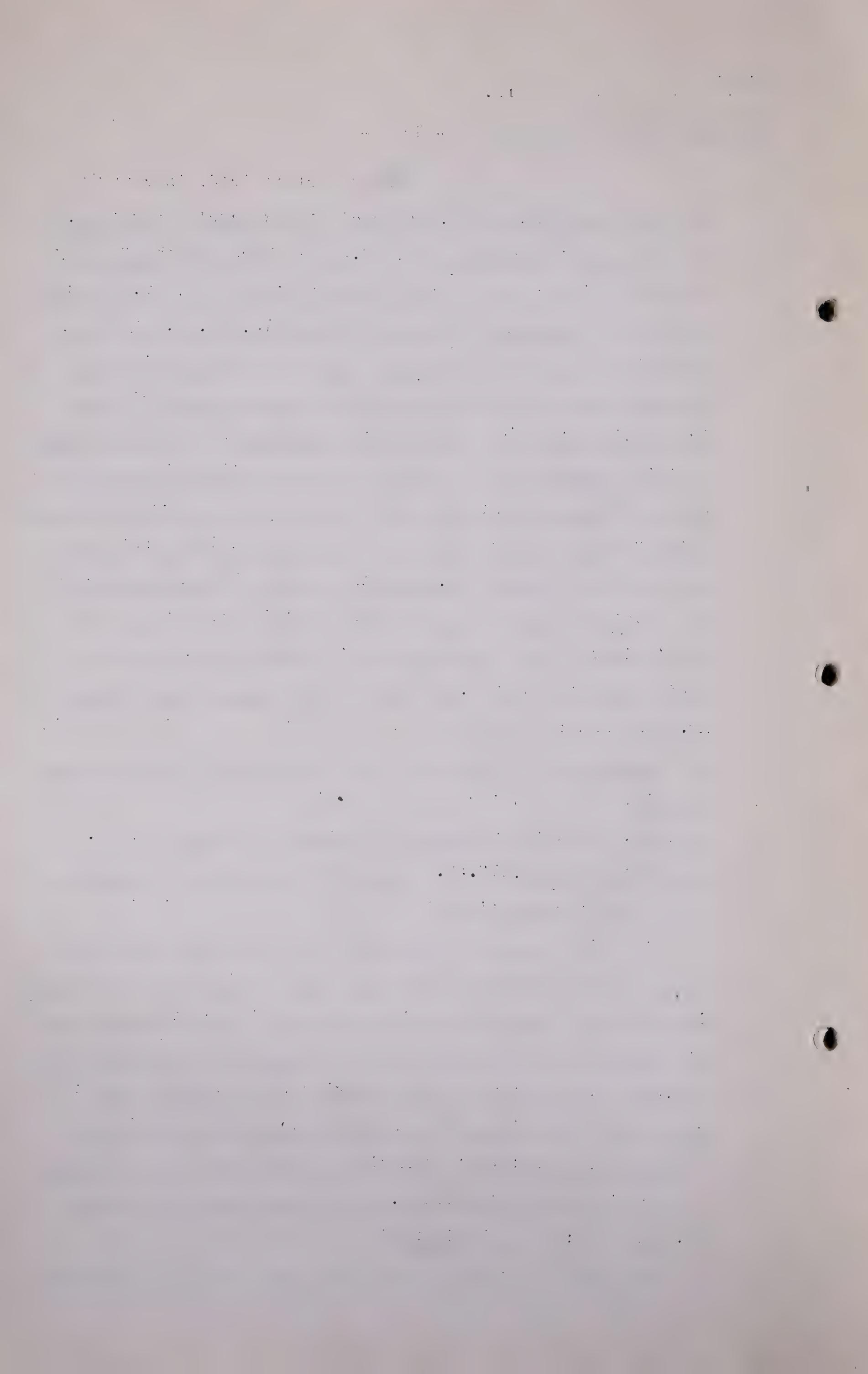
believe a small part in the early part of 1943, in changing from the, as I described, one cycle to two cycle operation, involved a total cost of \$32,417.52 of which sum the Company charged to its capital account to investment \$18,879.47 and charged to expense, operating expense, \$13,538.05. Now my understanding is and the information I have gotten is that the amount charged to investment represents the tangible physical equipment which was added to the processing system and that the expense represents the labour and intangible expenses which perhaps in part but not to any important degree would not have been incurred had the equipment all been installed at one and the same time. In other words the Company took a conservative view of the treatment of this expenditure and capitalized only that part which they presumed was a proper addition to the system.

Q MR. BLANCHARD: Would you give me those two figures again please?

A Yes sir. The amount charged to capital investment was \$18,879.47 and the amount charged to expense was \$13,538.05, or a total of \$32,417.52.

In connection with this too, I believe it is relevant to point out that at the time this change over took place and resulting from the conversion the Royalite recovered from its system or at least had in its possession contaminated diethelyne glyco which it now carries on its books now at \$42,319.35. The reason I am bringing that out now is that contaminated chemicals represents a substantial sum in terms of dollars, is not part of Madison working capital and was not acquired by that Company.

Q MR. CHAMBERS: Madison did not take over or buy from the



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Company this Glyco?

A That di-ethelyne glyco, no sir, it did not. It is still in the possession of and owned by Royalite.

Q That pretty well covers the story?

A There is one other point that should be brought out to complete the picture as a result of the difficulties which were incurred in the operation. The Girdler Corporation after some negotiations, I understand, agreed to suspend the through put royalties to a total of \$5,000.00 United States dollars. In other words, I am not certain of the period that the suspension of royalties took place over, but Girdler permitted a volume of gas over and above the ten million standard cubic feet a day to be purified by their plant without payment of royalty until through put royalty had amounted to \$5,000.00 which I have hastily computed and I will not answer as to the accuracy of the figure, \$5,542.52 Canadian dollars, so that represents a substantial reduction.

Q But they allowed that as a credit against the monthly royalty that was payable under Clause 6 of the Exhibit?

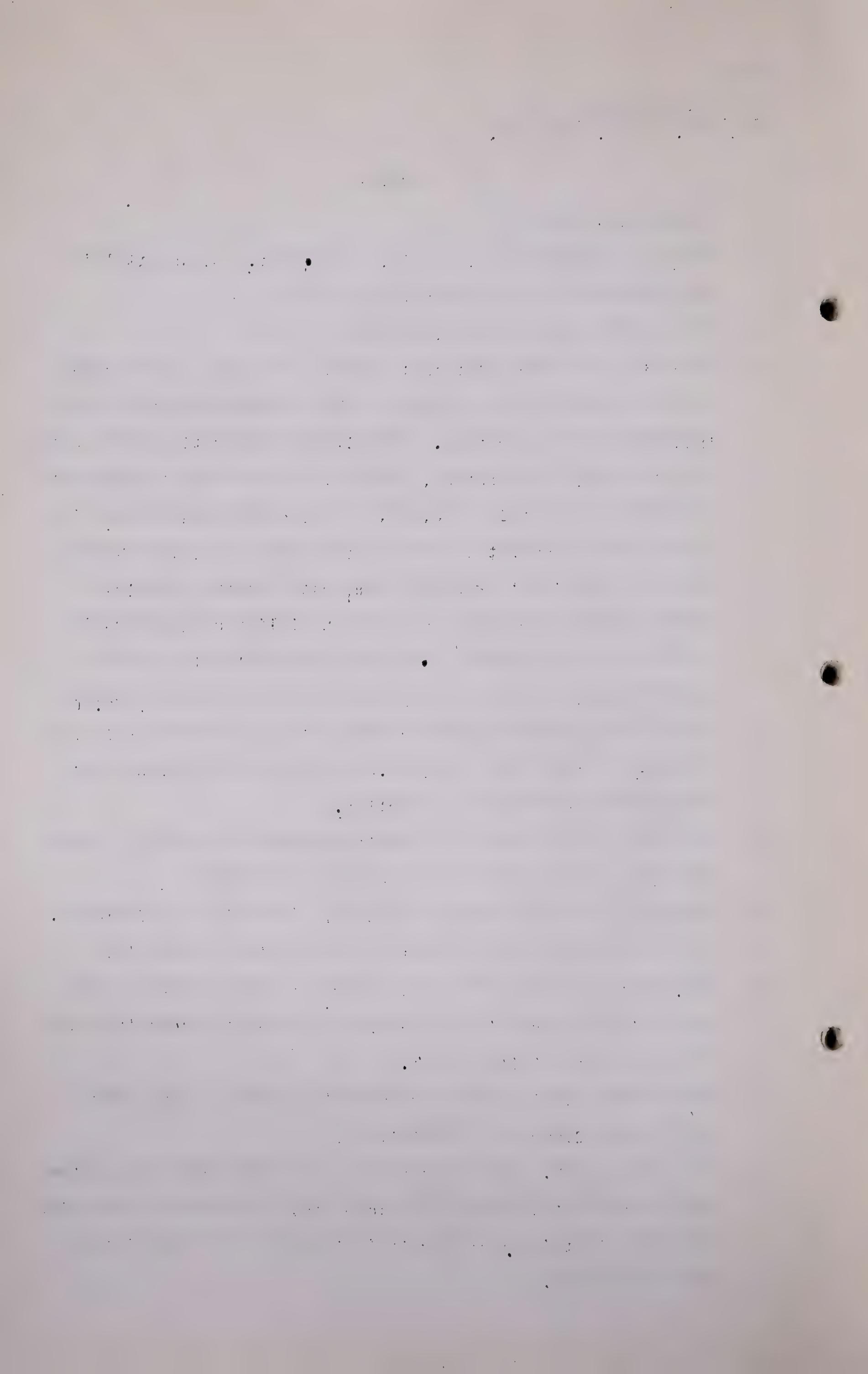
A Clause 6 of the through put royalty. There is no adjustment.

Q Do you pay through put royalty on everything you put in?

A Yes, that is paid monthly and charged to the expense of the system in the month it is incurred to which is added the amortization of the initial cost.

Q The through put is such that there is royalty to pay every month under Clause 6 of Exhibit 72?

A Not every month. There may be the odd month where the system might have shut down for the odd month, but generally speaking when the plant is operating it is in sufficient quantities to pay the royalty.



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Q And that royalty is one-quarter of one cent per thousand cubic feet in American funds?

A Yes.

Q I think then Mr. Kirkpatrick I have pretty well dealt with the assets that we have taken over from Royalite. Is there anything else that occurs to you in that regard at the moment?

A I cannot think of anything at the moment that has not been covered.

Q The Board will understand if there is anything we have overlooked we will have the opportunity of bringing him back. Now then you have prepared on behalf of Madison Report M-7 which is entitled: STATEMENTS OF

A - Actual and Estimated Capital Additions

B - Material and Supply Inventory

C - Cash Working Capital, Years 1944 - 1948.

A Yes sir.

Q Copies of this have been filed with the Board and distributed.

DOCUMENT REFERRED TO NOW MARKED
EXHIBIT 74.

Mr. Kirkpatrick, would you read Exhibit 74 and make such comments and explanations as you go along and as you may see fit?

A I might say first that Exhibit M-7a is submitted in that order following 6 and 6a because I believe that the three Exhibits are related and constitute the basis for rate base determination. The first page is merely an index and can be passed over.

Explanation of Schedules Included in Report M-7

INTRODUCTION:

The following comments are intended to explain the several schedules attached to and forming Madison Natural



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Gas Company Limited Report M-7 for submission to the Natural Gas Utilities Board at the Natural Gas Rate Hearing opening March 12th, 1945,

The attached schedules contain the following general information:

"A" GROUP - Actual and estimated capital construction costs for the years 1944 to 1948 inclusive.
(Actual for 1944 and estimated for 1945 to 1948)

"B" GROUP - Analysis of Material and Supply Inventory as of November 30th, 1944.

I might explain why that date November 30th, 1944 is taken. That happens to be the date when the complete physical and visual inventory of the equipment was made in Turner Valley and therefore an opportunity for a cut-off.

"C" GROUP - Estimated Cash Working Capital (Years 1944 to 1948 inclusive).

SCHEDULE M-7-A/44

SUMMARY OF ACTUAL CAPITAL CONSTRUCTION COSTS

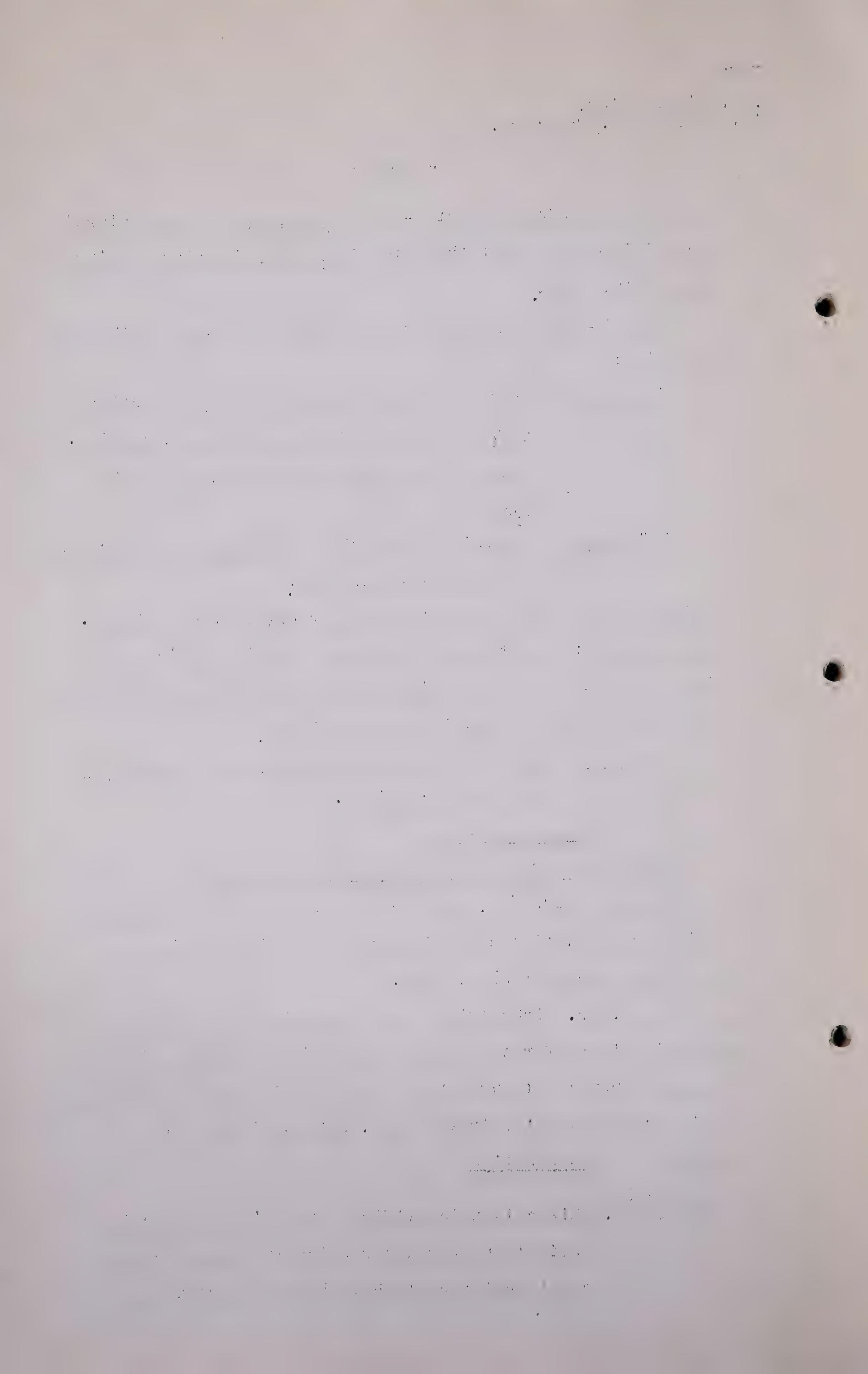
Schedule M-7-A/44, Pages 1 and 2, set forth the actual capital construction costs incurred by Madison during the year ended December 31st, 1944.

Q Just there, Mr. Kirkpatrick, as I understand the 1944 construction is by far the greater part of the construction the Company carried out pursuant to the Board's order last spring?

A Last spring and later in the year, substantially so.

Column Explanation

Construction Estimate No. This column identifies Madison's construction estimate number under which the actual capital construction costs have been assembled and are



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inserted herein for purposes of ready identification only.

Particulars This column identifies the general nature of construction work commenced during the year 1944 grouped by the respective Natural Gas Utility Board Orders under which the construction was undertaken in those instances where such construction was by direction of the Board. The Costs grouped under Construction Estimates 15 to 18 inclusive are in respect of the looping and extension of the North Gas Gathering System and related ancillary compressor and other equipment. All construction estimates contained on Page 2 of Schedule M-7-A/44 cover sundry capital construction costs and are self-explanatory.

(1) Material

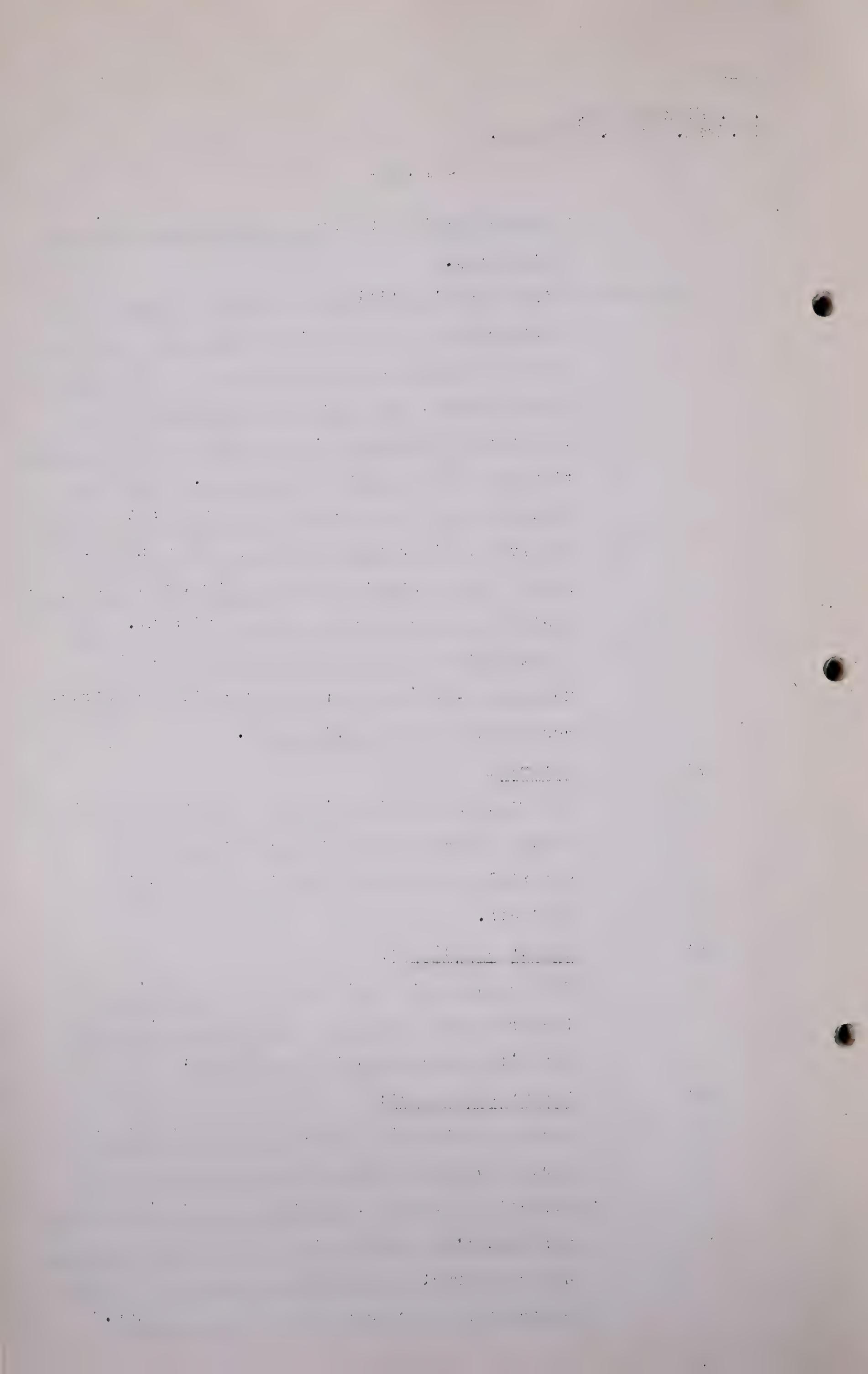
The figures contained in this column represent actual laid-down Turner Valley costs of all material used in the respective construction projects.

(2) Labour - Madison:

This column sets forth the total expenditures incurred within Madison's own organization and with its own construction personnel.

(3) Labour - Contract:

Because of the time element and the inability to secure sufficient skilled and semi-skilled construction personnel, a substantial portion of the work undertaken during the year 1944 was performed under contract and the costs in respect of such contract work are contained in this column.



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Q That is a Gentry contract?

A Not all of it Mr. Chambers. If you will refer to the total of Column 3 of Page 2 of this particular Exhibit you will find a total under contract of \$63,991.91 and I have the breakdown of that total as follows under the Gentry contract the sum of \$56,324.23 was spent, ^{and} to others \$7,667.68. The others represent welding work done by contract and I believe some construction work by construction contract such as running cement foundations. The reason we have shown the labour broken down into those two classifications is so as to set forth that all the work was not done by our own personnel.

(4) Machine Shop Work:

All costs contained in this column represent the costs of work performed in machine shops.

The reason that is shown separately is because machine shop work is really a combination of material and labour and other intangibles and it is not readily possible for us to show the difference so where I say the column contains all the difference I should qualify that by saying Column 4 does not contain an element of material as opposed to labour. I have not the exact information as to the breakdown but I should guess fifty-fifty.

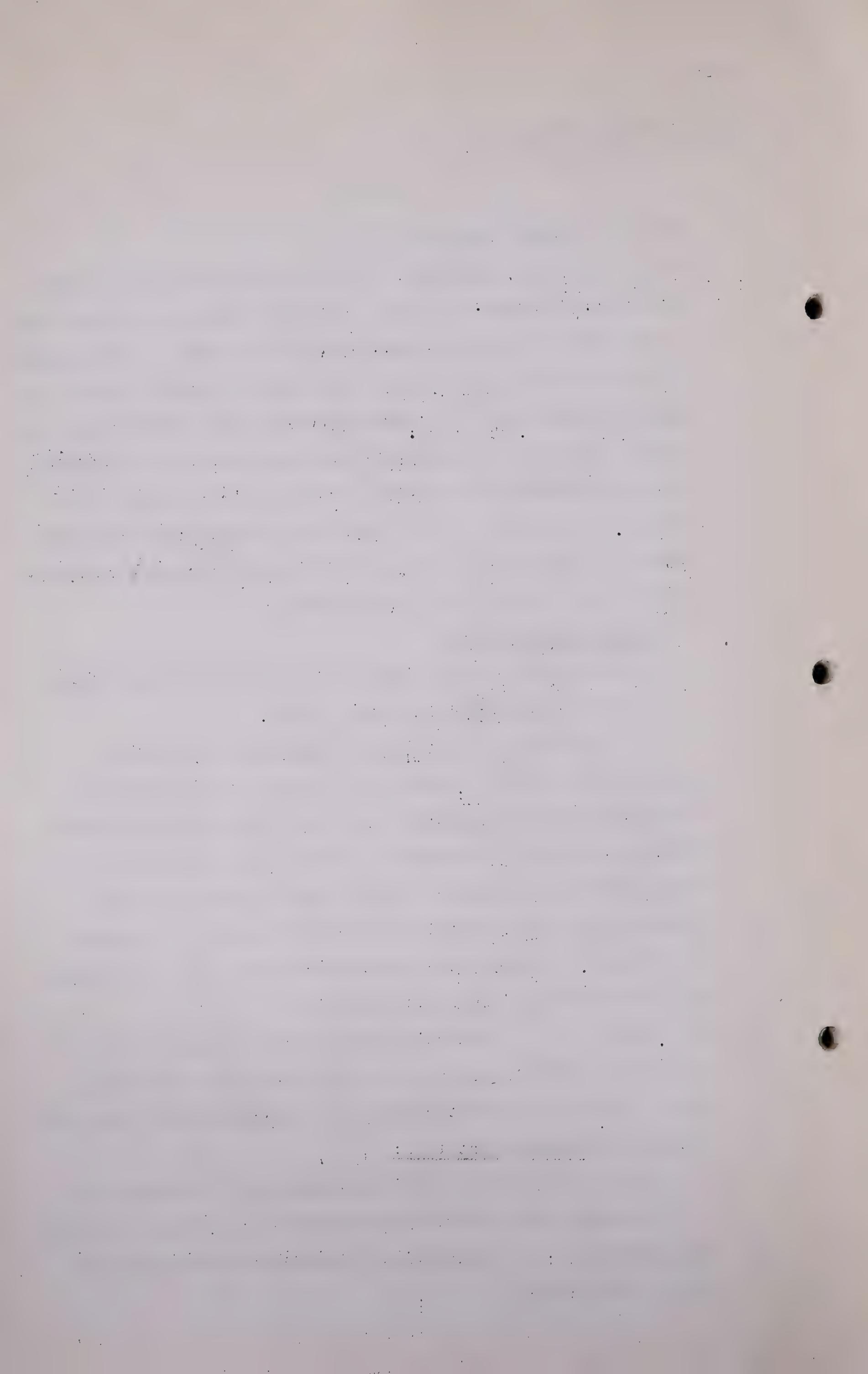
Q DR. BOOMER: Machine shop is your own work?

A No that is machine shop work done by Royalite. We have a small workshop but not capable of performing machine shop work.

(5) Field Transportation:

All costs contained in this column are in respect of material and personnel transportation in Turner Valley.

Q THE CHAIRMAN: And will not include the transportation of the Gentry men?



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A No sir, that is included in their contract.

Q MR. BLANCHARD: It is transportation of material from the Railway to the job?

A No, that transportation is included in the material cost in Column 1. The Column which we have headed "Field Transportation" is the cost of material transportation and personnel transportation within the field itself and when I speak of material transportation I refer to print of warehouse to the job.

(6) Sundry:

The costs contained in this column are those items which do not directly identify themselves with any of the phases of construction under Columns (1) to (5) inclusive.

(7) Total Cost to December 31st, 1944:

This column is the sum of Columns (1) to (6) inclusive.

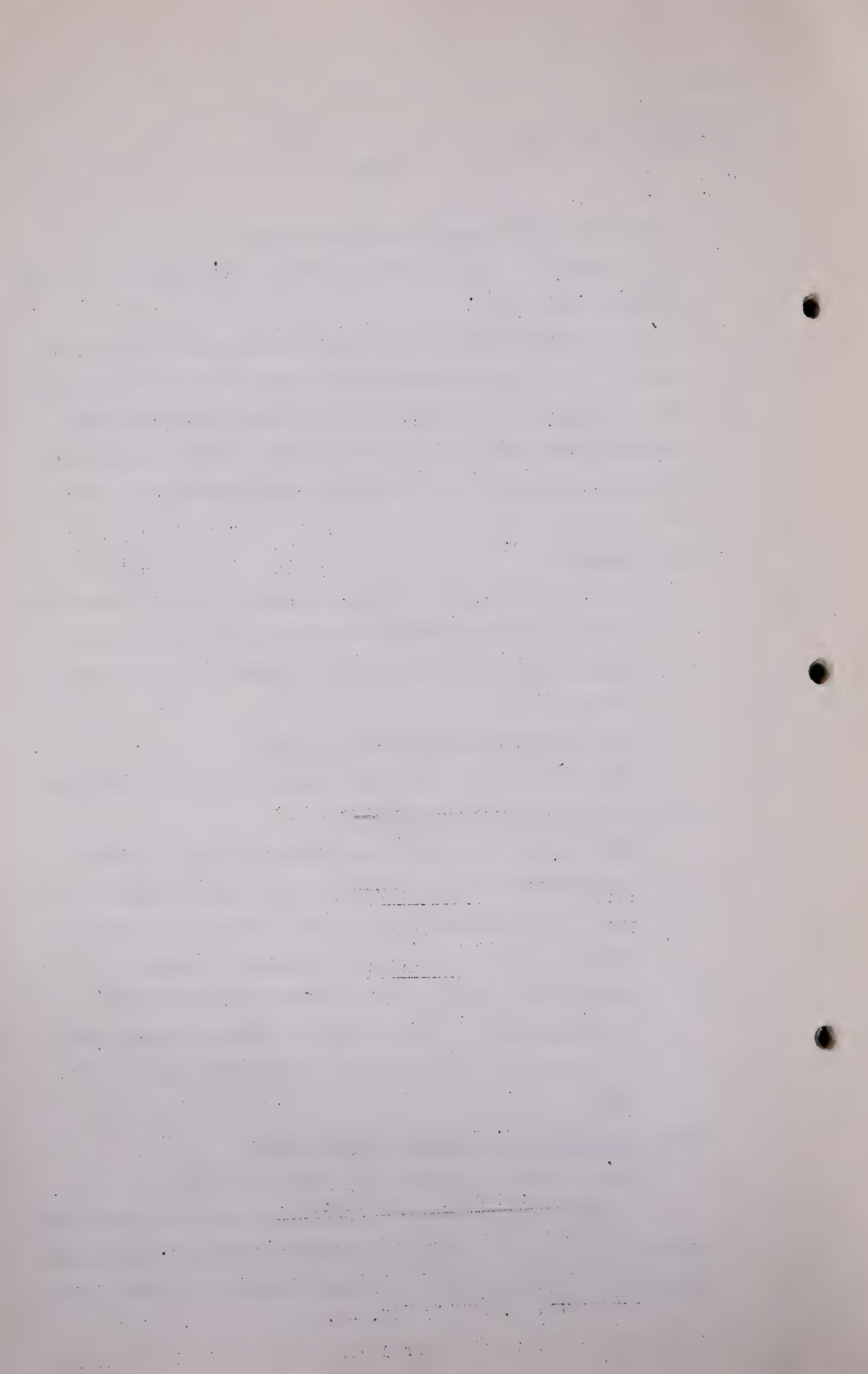
(8) Estimated Cost to Complete:

This column represents the estimated cost to complete projects commenced in the year 1944 and standing incomplete as at December 31st, 1944. It will be observed that the grand total amount contained on Page 2 of Schedule M-7-A/44 is carried forward into Column (1) of Schedule M-7-A (years 1945 to 1948) as these funds, it is estimated, will have to be expended in the year 1945.

(9) Total Estimated Cost to Completion:

This column is the sum of Columns (7) and (8).

I might perhaps enlarge on that by saying that the total amount in Column (1), namely \$47,450.00 is the estimated sum necessary to complete those projects commenced in 1944 and by



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reason of the fact that it will be expended in later years it is the first item appearing on Schedule M-7-A. In other words they are expenditures to be incurred in subsequent periods.

SCHEDULE M-7-A

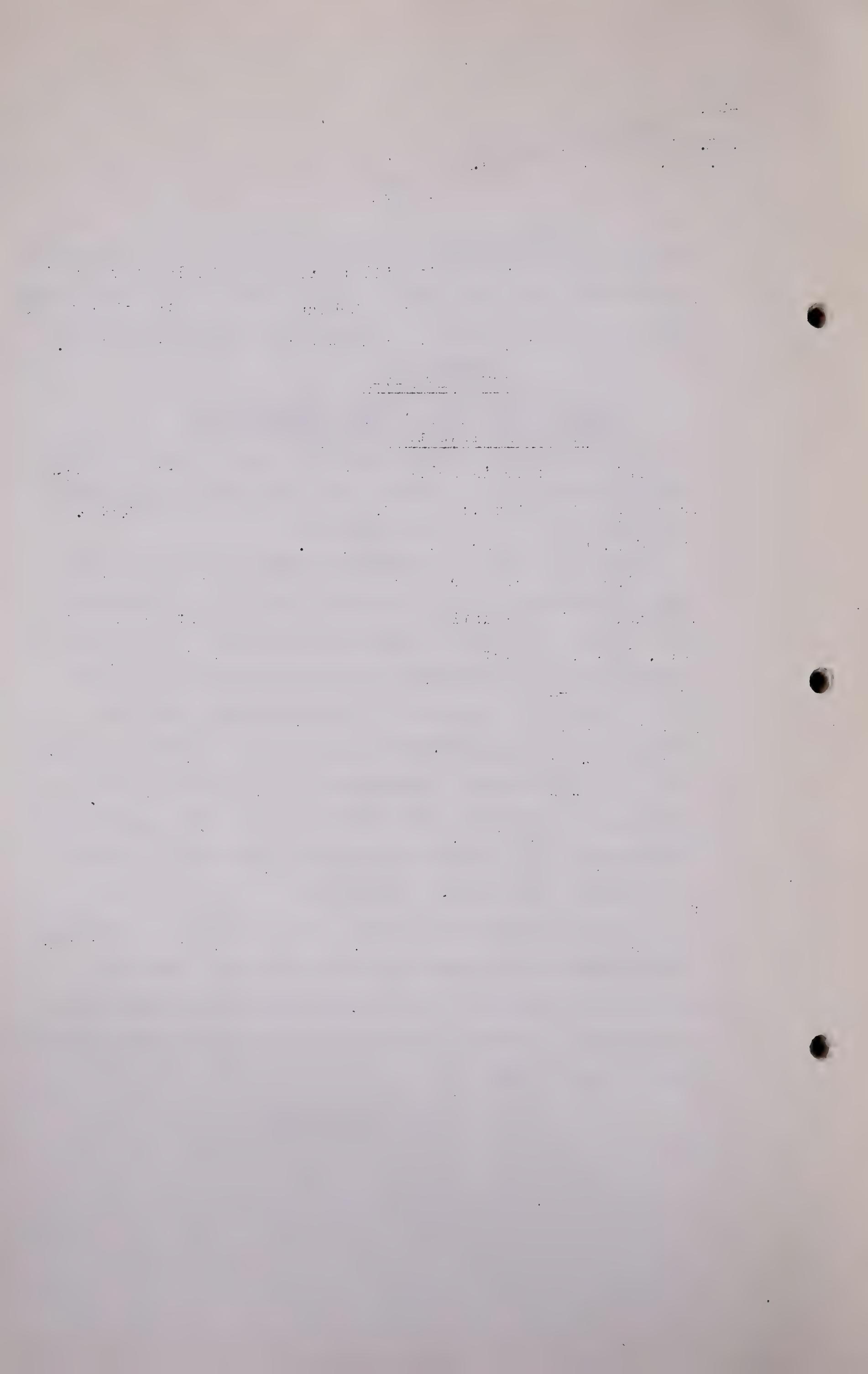
SUMMARY OF ESTIMATED CAPITAL CONSTRUCTION
COSTS YEARS 1945 to 1948 INCLUSIVE

This schedule is self-explanatory and attention is directed only to Item 1; namely, the carry-over of \$47,450.00 from Column (8) of Schedule M-7-A/44.

Since the actual construction costs for the year 1944 were not available until the date of this report (February 15th, 1945), the actual costs as set forth in Column (7) of Schedule M-7-A/44 and Column (1) of Schedule M-7-A (years 1945 to 1948) will necessarily differ slightly from the estimated capital construction costs as set forth in Columns (2) of the "D" Group of schedules of Madison Report M-9. For purposes of comparison, the following table will demonstrate the extent of the differences between actual and estimated for the year 1944 and the year 1945.

M-9 has not been submitted. It is a report containing our estimate of the operating costs for those respective years by plants or units and at the time it was being compiled late in 1944 and very early in 1945 we had only approximate costs to work on.

(Go to Page 1836)



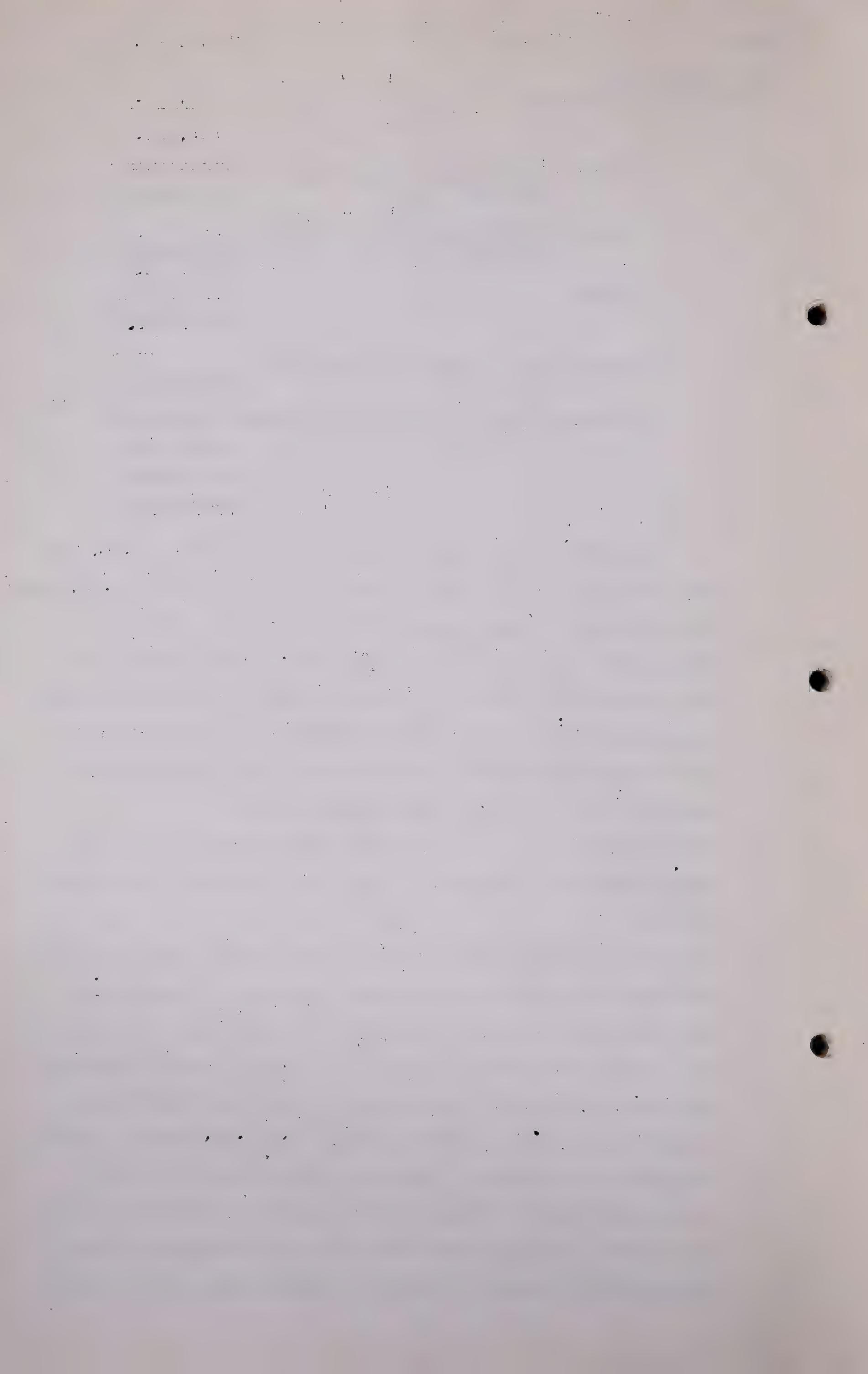
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In other words, that is the figure at which we have the operating figure for future periods as opposed to actual figures not contained in this report. The actual for 1944 is \$359,523.00, and the estimate for 1945 is \$172,860.00, or a total actual for 1944 plus estimated 1945 of \$532,383.00, which is approximately a difference of \$7000.00, a little over 1% in our estimated capital construction. That finishes the remarks on our estimated construction costs.

Q MR. CHALBERS: At that point is there any point going through the Tables? Is there any particular observation on them?

A I do not know that I have anything particular to offer on those, Mr. Chambers, unless you have some questions. I might point this out that referring to Schedule M-7-A/44, Page 1 - I beg your pardon, referring to Column 7 of M-7-A, page 2, the total actual cost to December 31st, 1944, is shown as \$359,523.00, and pursuant to your question a moment ago, that these expenditures were substantially under the direction of the Board, by specific orders of the Board the amount of expenditure was \$217,612.28. And the loop extension in the North end of the field is \$105,474.42, or a total of \$323,086.70, either under



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direct order or with the knowledge of the Board. In addition to that the sundry incidental additions to plant and equipment during the year, which we would presume the Board would not direct a specific order on, total \$36,436.30, and comprise mostly the incidental items shown on page 2, the water cooling system, purchasing meters, sundry tools, constructing workshop, pipe line rights-of-way, the purchase of a truck and so on.

Q Well then, in Schedule M-7-A, 1945 to '48, which is the estimate of capital additions for the years 1945 to '48 inclusive, you did not just pick those figures out of the air, you must have consulted with some of the engineers?

A Well we asked the engineering staff and Mr. Stevens-Guille of course, to give us some knowledge of what they might anticipate would be required and a study was made of what probably would be carried over in 1945. That is the first figure at the top \$47,450.00, and the remaining items are either items which have been under consideration during the past year and will be constructed either in '45 or future periods. And there are one or two items in there, perhaps you might refer to the last one, item 19, extending gas gathering systems, we have nothing specific in mind in that case. We put it in because we presume there will be bound to be something, either laterals or otherwise, to hook in on the wells coming into production. Apart from those items, I think everything else has been given some thought, and study, and I believe Mr. Stevens-Guille's submission M-8 will bring it out. The costs are based on estimates but they are based on past experience of something we have had done and on consideration.

Q To save the Board's time I propose to call Mr. Stevens-Guille as to the why and the wherefore of these proposed additions. All right, Mr. Kirkpatrick, you go now on to Page 5 of your

1861-1870
a few more before the first turned to gold which
had increased to 22

1871-1880

1881-1890
over 4000 workers, 2000 (3000)
and 8000 in 1890

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report.

A I think we have got down to the consideration of material and supplies. That is Schedule M-7-B. This Schedule sets forth the breakdown of the total inventory of materials and supplies as of November 30th, 1944. This Schedule was prepared following complete physical inventory as of that date and represents the value of materials and supplies contained in warehouse in Turner Valley or in transit thereto as of the date of the inventory.

That figure would necessarily change from month to month but I believe is an average representative figure. Now there is an explanation of that schedule. And it is headed:

<u>Column</u>	<u>Explanation</u>
Class	This column is merely to identify Madison's material classification.
Group Classification	This column is a general group of related types of materials and supplies as taken from the physical inventory sheets.

The physical inventory sheets in themselves constitute some eighty or ninety very complete and voluminous sheets, and they do not lend themselves into the form of exhibits so that we condensed them down into this particular form.

(1) Total Inventory:

This column represents the investment in warehouse of materials and supplies of all kinds on the above mentioned date. The line headed "Sub-total Physical Inventory on Hand" is the actual physical inventory of materials and supplies in warehouse on November 30th, 1944, and the line headed "Freight and Express Transit" and



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"Duty and Brokerage Transit" represents expenditures incurred by Madison in respect of materials and supplies in transit to warehouse on the same date.

Q I just do not follow where that is, Mr. Kirkpatrick?

A You are looking at M-7-B?

Q Yes?

A I am speaking of the last item at the bottom of the page.

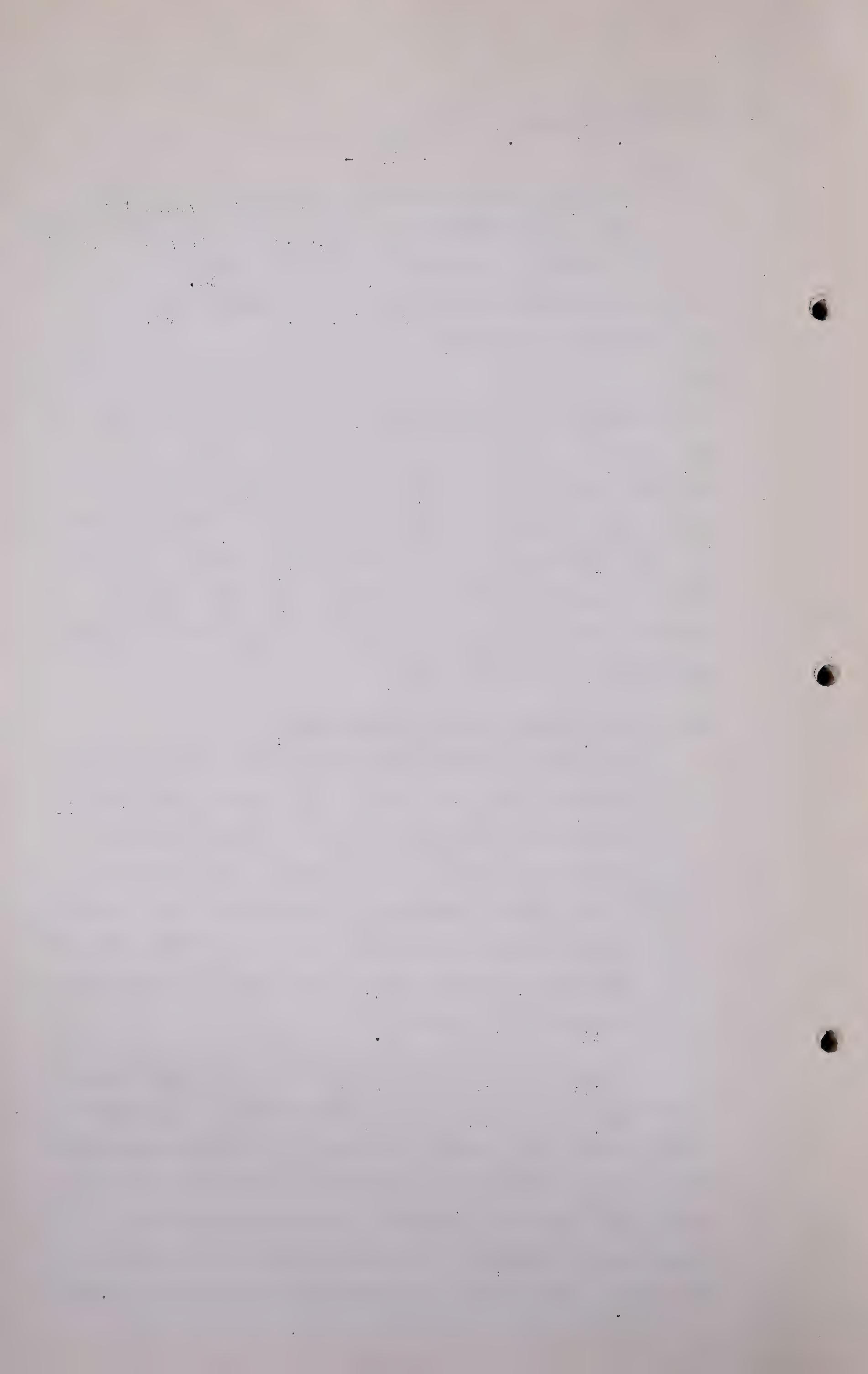
Q Oh, I see?

A The first one is headed "Sub-total Physical Inventory on Hand". That is what we could physically see. The next one is headed "Freight and Express Transit", and the next is "Duty and Brokerage Transit." Those last two items are costs incurred in respect of materials which were in transit to the warehouse on that date.

(2) Less: Capital and Extraordinary:

From the amounts contained in Column (1) have been deleted in this Column (2) the materials and supplies which have been identified as of a capital nature temporarily resting in this account before transfer to the capital construction accounts and also include any extraordinary items which are not normally maintenance materials and supplies and which are temporarily resting in this account.

I might say that that was a rather difficult thing to break down. It involves going through those 70 or 80 pages of the report that I spoke of a moment ago, attempting to say that certain materials and equipment are not normally maintenance and operating supplies, and we were successful in taking out what we think is a fair average representation of the same. The first item as shown on this schedule M-7-B is



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headed "Lumber and Timers", that should be "Timbers", that is a mistake in typing.

Q Where is that?

A That is item 17 on M-7-B.

Q Timbers?

A It should be timber instead of timers. You will notice that has all been deleted. Those were special pieces of equipment which were en route to the Seaboard plant which should have been installed in 1944 but unfortunately owing to the labour situation were not actually and will be installed in 1945.

Hence we thought it was fair to take that out as not representing a normal maintenance item. Similarly on Class 35-36 we have eliminated \$2,932.07. Substantially that represents meters which were en route at that time. Similarly in Class 63, line pipe, etc., three thousand five hundred odd dollars, which was representing the line pipe which was on its way to some of the capital construction jobs mentioned in the previous exhibit, was eliminated.

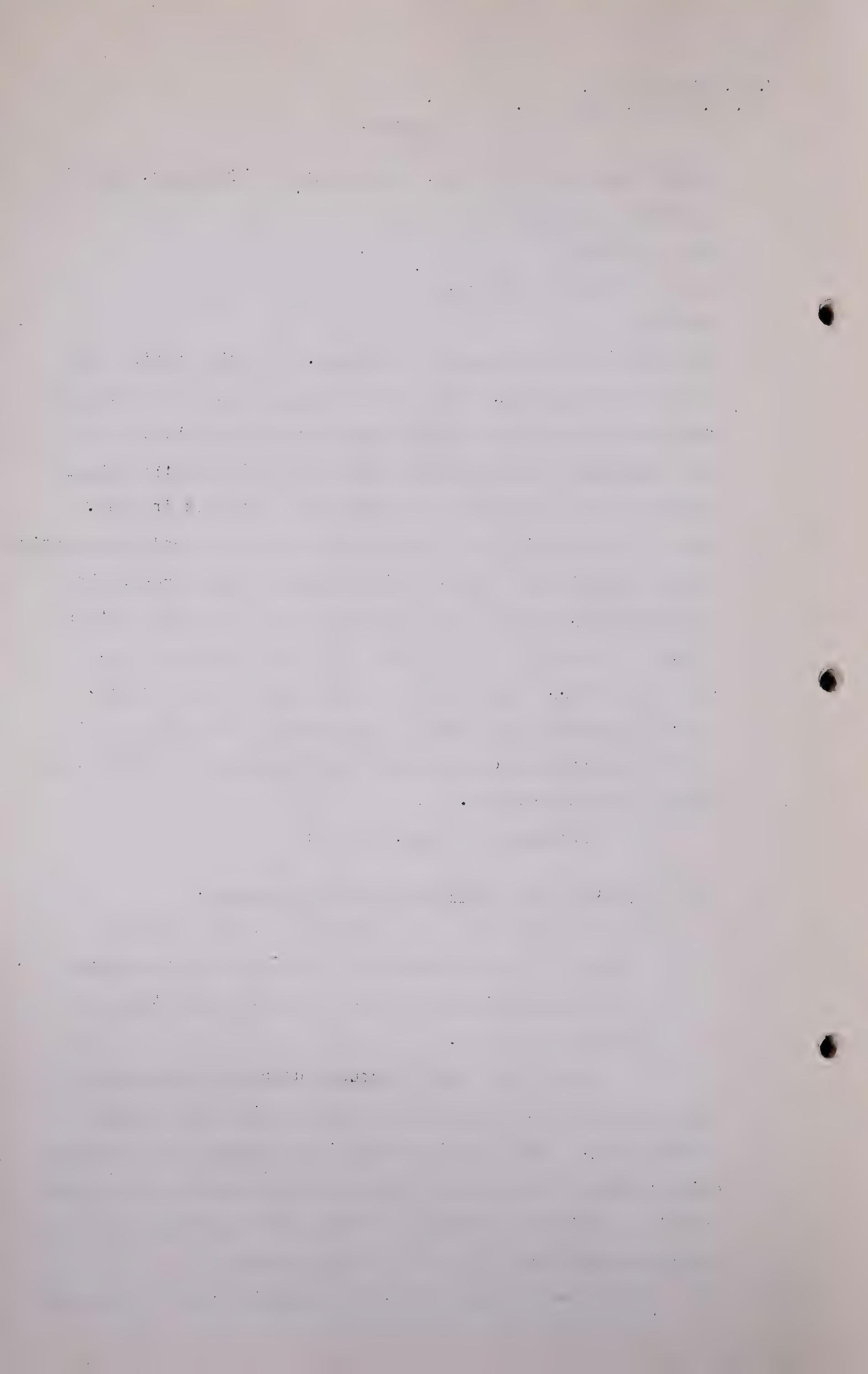
Now Column 3 then, headed:

(3) Net Operating and Maintenance Inventory.

This column is the sum of Columns (1) and (2) and represents the estimated net operating and maintenance inventory which Madison should carry at all times for normal operations.

That figure may fluctuate upwards or downwards from time to time, but I do not think it will vary to any great degree. This net inventory is not merely an accounting opinion alone. We checked this with the people in the field familiar with the practical operation and they looked it over and agreed with us it is a fair representation.

Q While you are on that page, Mr. Kirkpatrick, there is the item



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there of \$25,008.89?

A Yes sir.

Q I take it that has to do with the Girbotol plant, has it?

A Not all Girbotol. The Diethylene Glycol \$5,632.55 is Girbotol; the Soda Ash is Seaboard; the Monoethanolamine would be Girbotol; and the sundry chemicals, I cannot say what that is, probably a combination of each.

Q The point I want to get at and make sure is that this Glycol which was discarded, that is not in there?

A No sir. You are referring to the contaminating product.

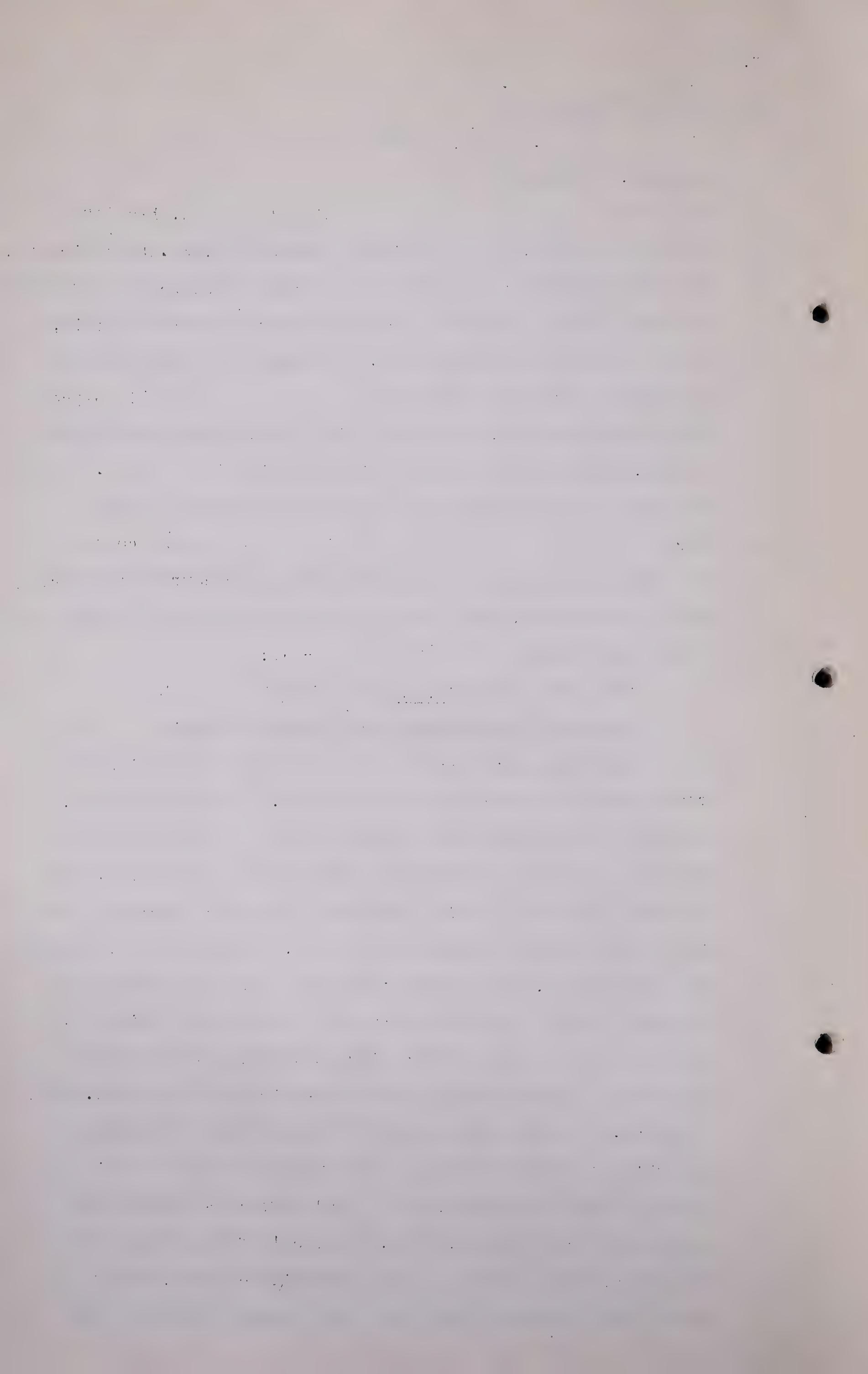
Q Yes?

A No, this is new unused stock contained in drums and containers which has not been used but will be used for current recharging from time to time.

The last schedule, Schedule M-7-C;

STATEMENT OF ESTIMATED CASH WORKING CAPITAL

Now this schedule M-7-C was prepared as will be seen from the second column and referring back to the estimated operating costs contained in Report M-9. In other words, we went back to the estimated operating costs and picked out of those costs what constitutes cash operating expenses. In other words, we have deleted depreciation which cycles through the plant and we have deleted anything, in other words, of a non-cash nature, except I must admit we did make a small mistake in our calculations, and on further review with Mr. Hamilton we found that we had included in our Tables an item in respect of the amortization of the Girbotol of \$4,012.00 per year. It sounds like a large item but when it is brought down to an average per year and in our submission represents 1/8th thereof, the actual difference amount to, I believe, about \$800.00. Mr. Hamilton's figure in his report yet to be submitted and our figure here, are for



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all practical purposes in agreement.

This schedule is intended to set forth the computations to determine the total estimated cash working requirements of Madison Natural Gas Company Limited for the years 1944 to 1948 inclusive.

The "Total for Five Years" of \$2,257,804.03 is the sum of Columns (6) to (10) inclusive. The "Average per Year" is the result determined by dividing the aforementioned sum by five. The "Cash Working Capital for Direct Operating Expenses" represents one-eighth of the average per year.

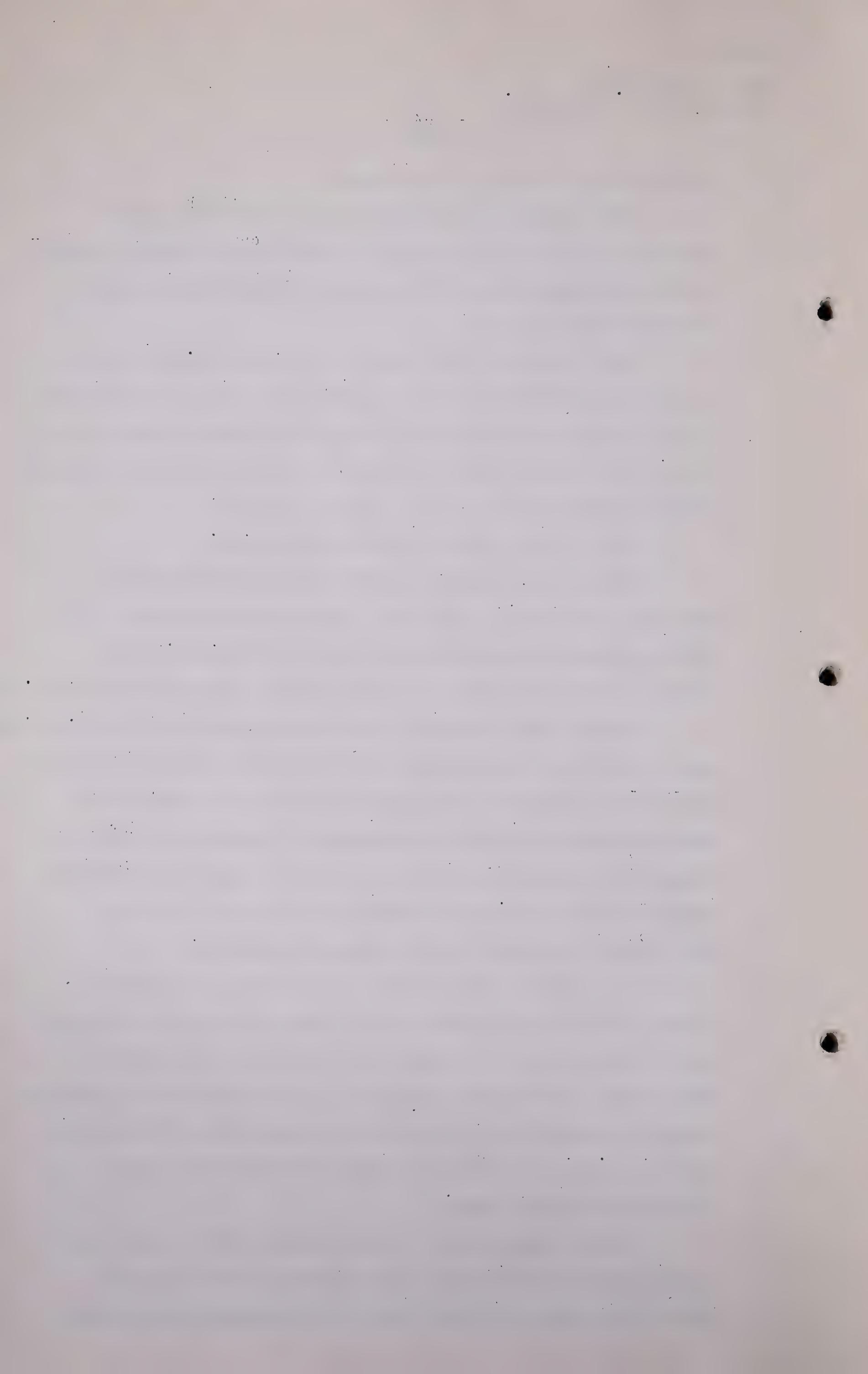
That is the figure shown as \$56,445.10.

To the cash working capital for direct operating expenses of \$56,445.10 has been added an allowance for "Cash Working Capital for Contingency Funds" of \$43,554.90 to arrive at the total estimated cash working capital of \$100,000.00.

To the total estimated cash working capital of \$100,000.00 as set forth on this Schedule M-7-C has been added the sum of \$90,000.00, being an even approximation in respect of net operating and maintenance materials and supplies as shown in Column (3) of Schedule M-7-B to arrive at the total working capital of \$190,000.00 set forth in Columns (1) of the "E" Group of Schedules under Madison Report M-9.

Just to clarify that. Referring to Schedule M-7-B, it will be observed that the amount in Column 3 being the Net Operating and Maintenance Inventory, the total is \$93,134.16, but for the practical purposes and for the purposes of this computation, we modified that down to an even amount of \$90,000.00. In actual practice it might be slightly higher or slightly lower.

Now in explanation of this Schedule M-7- , the first column headed Particulars, this column down to the line Total Direct Expenses, identifies the operating and service



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departments from which the costs herein contained were determined.

Schedule This column identifies the schedules from which the amounts herein contained were transferred.

(1) to (5) Total Direct Expense:

The amount contained in this group of columns will be found to agree with the total direct expense set forth on the "B" Group of schedules in Madison Report M-9.

In other words, we lifted the grand total from Schedule "B" and carried them into this column. They are exactly the same amounts.

(6) to (10) Net Cash Operating Expenses:

The amounts set forth in this group of columns represent the net cash operating expenses determined by deleting from the amounts set forth in Columns (1) to (5) inclusive all expenses which have been recycled from service units into operating departments. The result set forth in this group, Column (6) to (10), thus represents the estimated actual cash operating expenses of the Company.

Subject, of course, to the comment I made a moment ago that we had inadvertently included the \$4000.00 of Girbotol amortization.

The amount of \$43,554.90 identified as "Cash Working Capital for Contingency Funds" has been added to the "Cash Working Capital for Direct Operating Expenses" and is an allowance for cash working capital to provide Madison with cash funds for the following purposes.

(a) Periods of peak operations. The cash working capital for direct operating expenses is based on an average



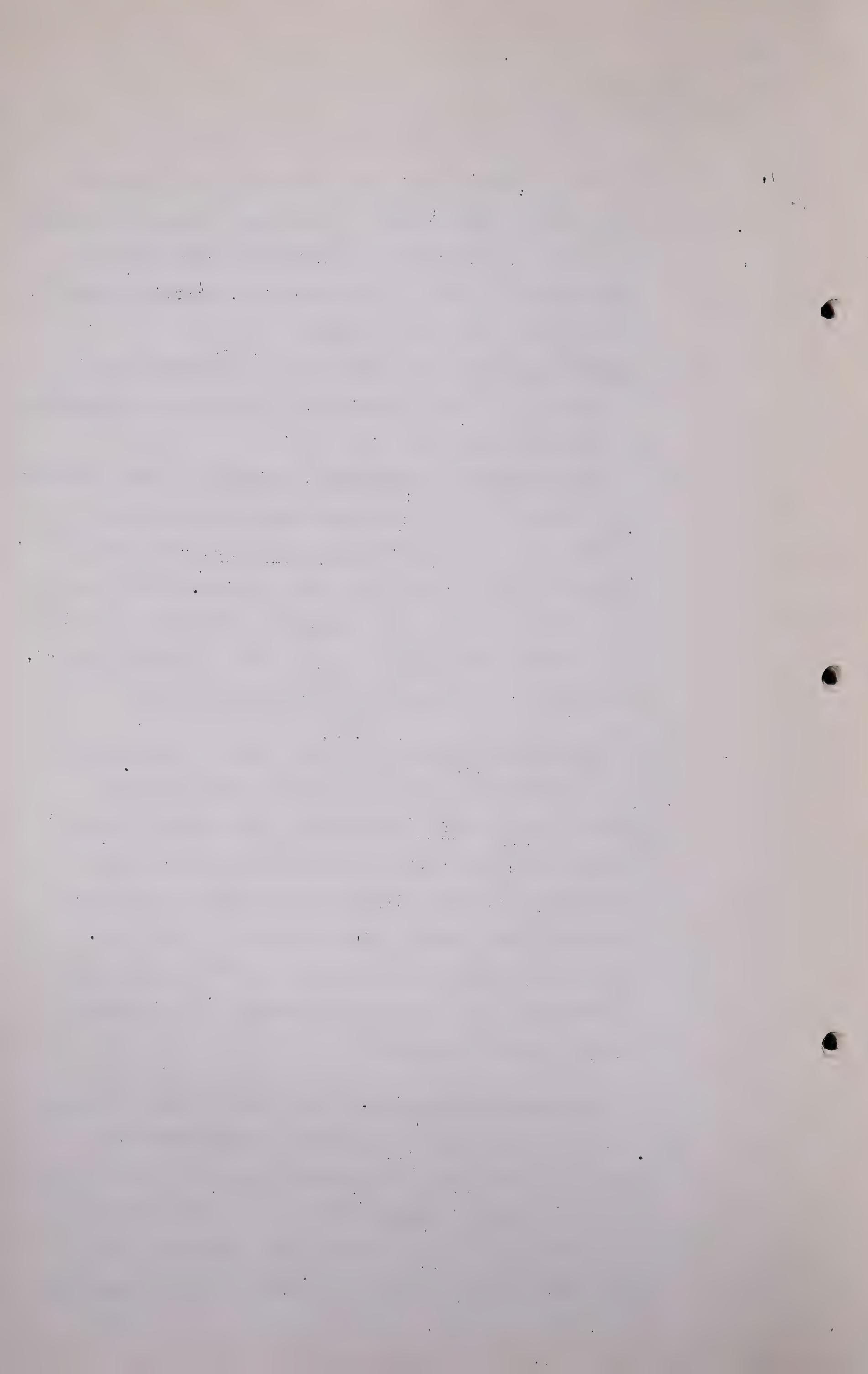
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of five years and does not provide for cash requirements for seasonal peaks of operation. Provision should therefore be made for such additional funds as must necessarily be available to provide the Company with cash to meet such peak periods.

(b) Prepaid Expenses. From time to time the Company will be required to prepay expenses. Examples of expenditures of this character are:

1. Prepaid Fire and Liability Insurance - Under Madison's arrangement with its insurance companies, a discount of one-half year's insurance premium is obtained through the prepayment of insurance for a period of three years. The actual insurance prepayment as of January 1st, 1944, was approximately \$18,000.00, and this recurring prepayment will arise each three years thereafter.
2. Rate Hearing Costs - Madison will be assessed with its proportion of the total costs of the current Natural Gas Rate Hearing expenses and will be expected to have funds available to satisfy its assessment. Although the Board will doubtless admit of the amortization of this expense over a period of, say, five years, nevertheless Madison must be in a position to satisfy its share of the said expenses at such time as the Board may determine.
3. Construction Materials - From time to time it will be necessary to incur substantial expenditures in respect of materials and equipment required for current and future capital construction, and, since Madison is asking for a rate of return for a period of only six months during the year of initial installation, it



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is considered fair and proper that a provision be made for cash working requirements for the acquisition of such capital construction equipment prior to its installation at a later date.

Q Mr. Kirkpatrick, in your estimate of \$100,000.00 for cash working capital, am I right in this, that you are assuming or taking it for granted that the Board will provide a lag between the time that you get paid by the Gas Company and the time that you are to make settlement with the producer?

A Yes, that is the assumption which we made at the time that this exhibit was filed, that in due course of events that there would have to be some slight lag, I don't know how long, say three or four days, between the date that the Madison's customers pay it for its service or product, and the date that Madison is required to turn over such moneys to the producer.

Q And you are assuming that even/ⁱⁿ a few days lag there will be no bad debts?

A Oh, I do not think the Canadian Western will be a bad debt.

Q What is the situation of payment now? What is the date that the Gas Company makes the settlement?

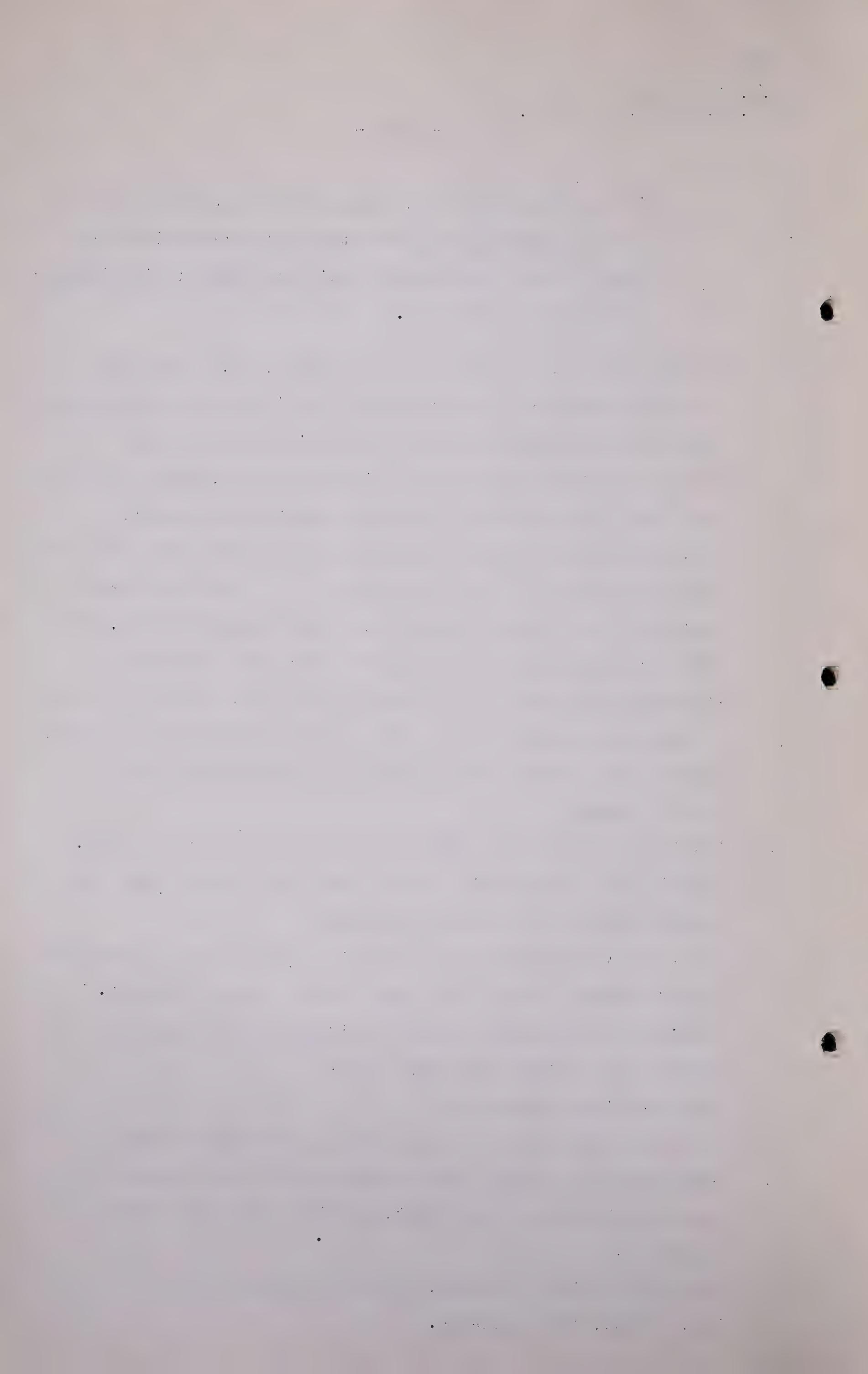
A Well, the contract requires payment to take place on the 20th of each month, and that date has in most cases been met. Occasionally a Sunday, holiday or long weekend intervenes and we have to wait a few days more.

Q And your other customers?

A The same with regard to them, they are required to have their money in there, they require to have their money in there on the 20th of the month, and they are very anxious to get it.

Q Referring to the customers, the other companies?

A Yes, I know, the producers.



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Q No.

A The other customers?

Q Yes?

A The same date applies, the 20th.

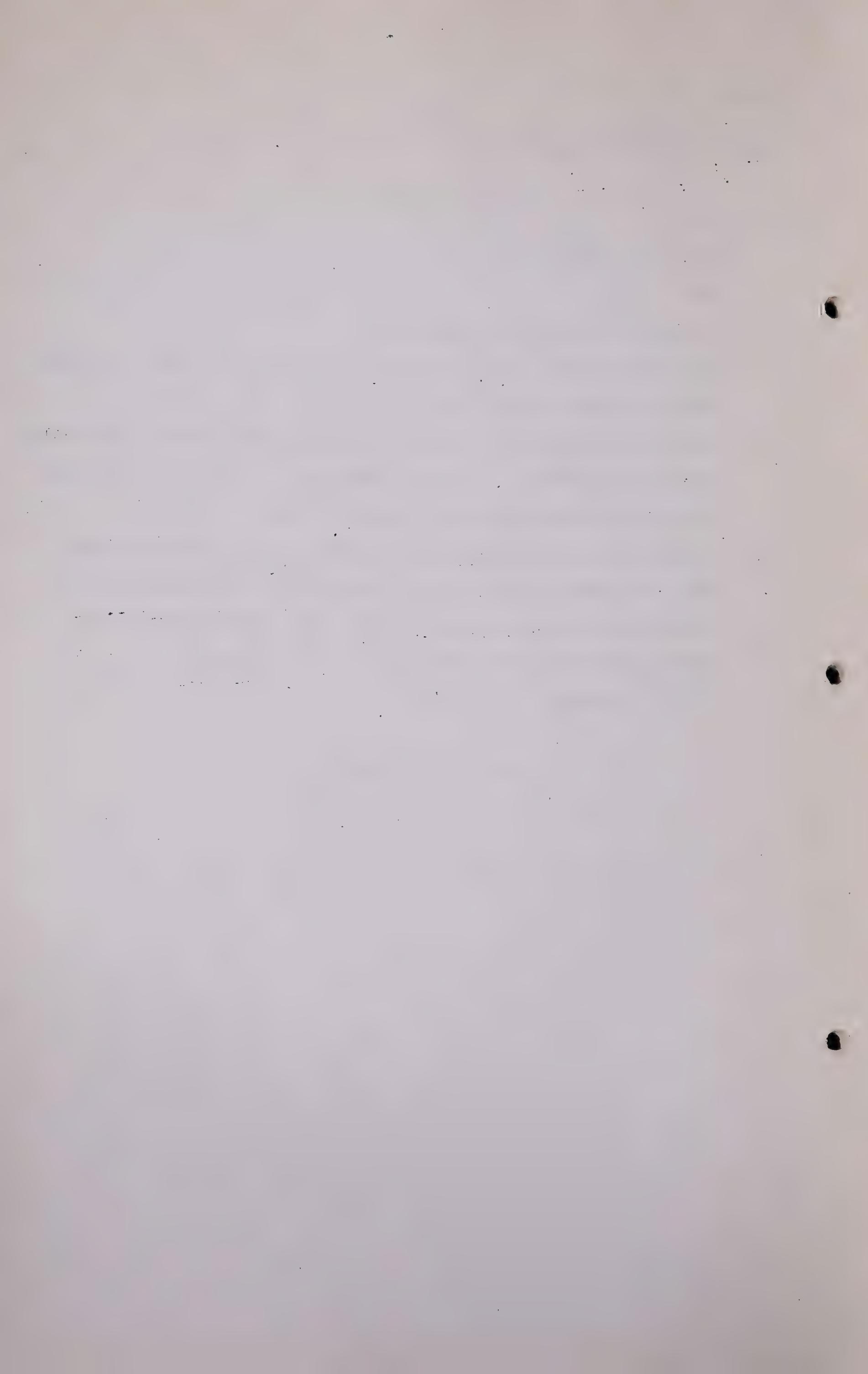
Q And to the people that supply you with gas, the date of settlement with them is the 20th, is it?

A Yes, that is correct. The date on which they are to receive the money is the 20th. In other words, they are required to have it in their hands not later than the 20th.

Q I mean, the circumstances under which you are actually operating are these then, that you now send out the cheques to the producers before you actually get in the funds from the Gas Company, and the other companies, is that right?

A That is correct.

(Go to Page 1847).



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Q Your \$56,445.10 item of M-7C is one-eighth of your operating expense of \$453,575.32, is that right?

A No, sir. That 453 thousand, I do not see where that is. It is one-eighth of the average per year of \$451,560.81 and that average is computed by totalling the estimated expenses for the 5 year period which are contained in columns six to ten inclusive.

Q Do I understand correctly on pages 9 and 10 of your report, which is Exhibit 74 you give your reasons as to why this further amount of \$43,554.90 should be included?

A That is correct and not contained in there I should have added in there perhaps the fact that in my opinion anyway the company should not be required to operate on a bare minimum operating expense basis. I think there should be some cushion or provision, something above that point. In other words, the \$56,445.10 is our best estimate of the amount which is likely to be the cash operating requirements for 5 years but I believe there should be something over and above that amount.

CROSS-EXAMINATION OF THE SAME WITNESS BY MR. FENERTY.

MR. FENERTY: There are several questions I would like to ask Mr. Kirkpatrick and I will not be in a position to close my examination in the time that is left this morning. I have never had access to one of the documents we have put in but my friend is going to give me copies. I have not got them yet. But there may be several things I should refer to so that if I require them we can have them a little later.

Q Mr. Kirkpatrick, in this Exhibit 68, the consideration for the assets

A Are you referring to the contract, is that the Girbotol contract?

Q That is the agreement of the 10th of March between the Royalite



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and Madison transferring the assets, the general agreement.

A Oh yes.

Q You get the consideration there expressed as being 2,899,994 full paid up common shares. I am assuming that that was treated as the equivalent of that many dollars, is that right?

A No, sir, not necessarily.

Q I see. In making that transaction you were not working in dollar values?

A Well there is no dollar value attached to this particular reference. You are referring to the 2,899,000 shares and the consideration for that is the transfer of the physical assets.

Q All right. What was the company paying for it in dollars? No dollars at all?

A What is Madison paying for it?

Q Yes.

A They could not pay dollars, the company has no funds. They are being set up by Royalite for the first time.

Q Pardon me, what I am trying to get at is this, you had no valuation shaped in the medium of exchange in this country, which is dollars, for the assets being transferred.

A Oh yes, but they are contained in the appraisal report.

Q How did you happen to hit on that number of shares as being issued for these assets? Why wasn't it one million shares?

A I suppose it could have been a million shares if necessary but it was not necessary.

Q What do you mean, it was not necessary?

A The shares were issued without consideration but by the company's charter were to be issued at a consideration not in excess of a dollar each.

Q Now we are getting back to it. The Company's charter, I take



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it, provides they may be sold or disposed of for a consideration not to exceed one dollar.

A That is correct.

Q And it was on that basis of consideration of one dollar was it not that this transaction went through?

A No, not a dollar for each share. The total value which Mr. Hill has appraised for the Madison Natural Gas Division is something less but I do not recollect the exact figure.

Q You do not understand me and it may be my fault. You are the Secretary of the company that has seen fit to issue 2,800,000 odd shares as fully paid up.

A Correct.

Q Those shares are supposed to have some value, you know. You might sell or dispose of them for a sum not to exceed a dollar a share and I want to know whether they were disposed of for a consideration of one cent or one dollar.

A We have reduced them to the values - the actual transaction was that we acquired the assets, physical assets, materials and supplies and \$100,000. cash.

Q For?

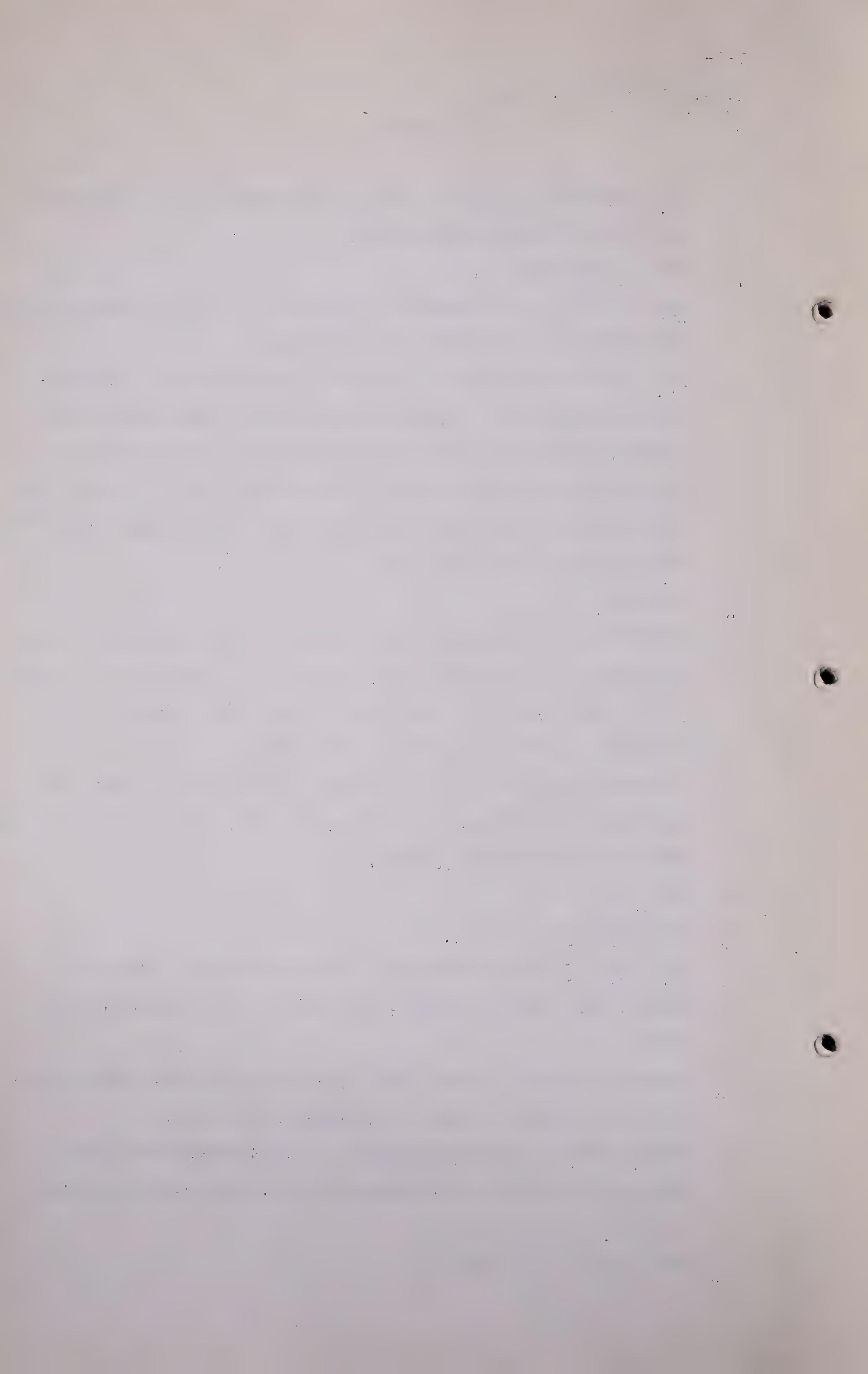
A For 2,899,994 shares.

Q All right. Did you pick that figure out of the air. Why didn't you pick one share? Just why did you pick 2,899,000 odd?

A Because that is a figure which represents or very close to it, a dollar per share which the charter calls for.

Q That is what I am trying to get at. So that you did deal with these shares on the basis of \$1. a share or very close to it.

A Very close to it, yes.



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Q That is what I want to get at.

A Well it should be 2,899,994 shares divided by Mr. Hill's valuation. That is the answer. Something less than a dollar.

Q You must have worked out the price per share to put this deal through.

MR. CHAMBERS: I object to that kind of a question. You can ask him how he did it but you cannot say what he must have done.

MR. FENERTY: Perhaps that is wrong. I do not blame my friend for being sensitive about this agreement.

MR. CHAMBERS: I am not sensitive about it. I am sensitive about the way you ask these witnesses questions.

MR. FENERTY: We will get at it before we are through. You cannot hide everything.

THE CHAIRMAN: I do not know. There is a lot of liberty allowed in cross-examination, you know, Mr. Chambers.

MR. CHAMBERS: But he cannot ask the witness -"you must have done this." -

MR. FENERTY: All right, I apologize.

Q Now we will have a few more questions. You did put a valuation on what you were buying, did you?

A That is correct and that is the valuation reflected in the company's books.

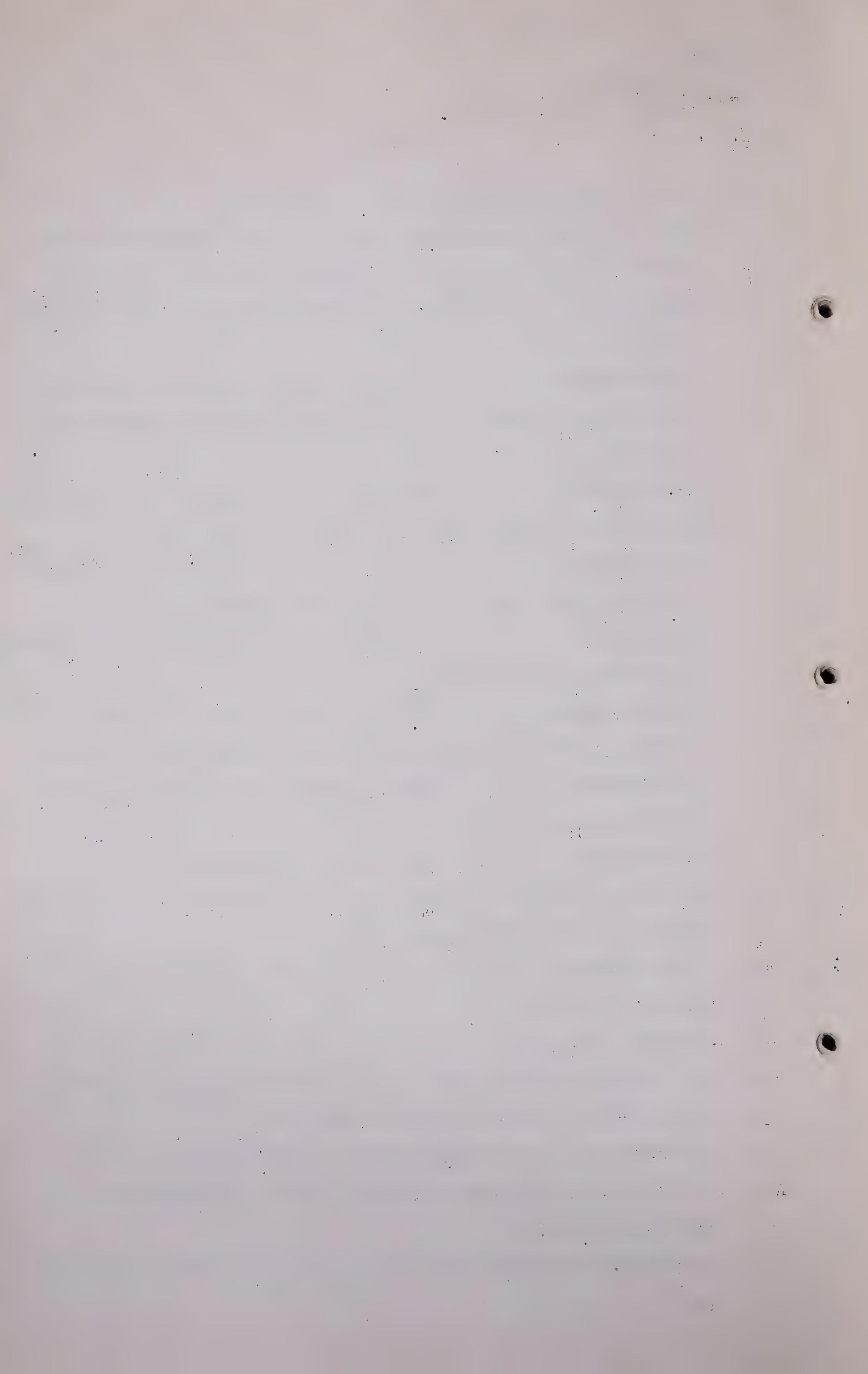
Q And what was it?

A It is the sum total of Mr. Hill's appraisal plus, as shown in Exhibit M-6 or Exhibit 59 and Exhibit 60.

Q The sum total of the figures given by Mr. Hill?

A Given by Mr. Hill in his appraisal report identified as Exhibits 59 and 60.

Q You bought a lot more than that, didn't you, from the things



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he talked about. You bought the natural gas contract, did you have any value for that?

A That is set out on the books.

Q I am talking about the chief contract. We will shorten this up and I wonder if you could provide, perhaps tomorrow, a break-down of what values were attached to the various things which you purchased under this contract.

A Well that is these reports we have provided for in Statement form.

Q Yes, I see good will. You purchased that?

A That is part of the consideration but you wont find it on the books of the company.

Q You did purchase the good will but you did not pay anything for it, is that right?

A That is right.

Q You purchased the gas contracts?

A Yes.

Q You did not pay anything for them?

A No.

Q They were just given to you were they?

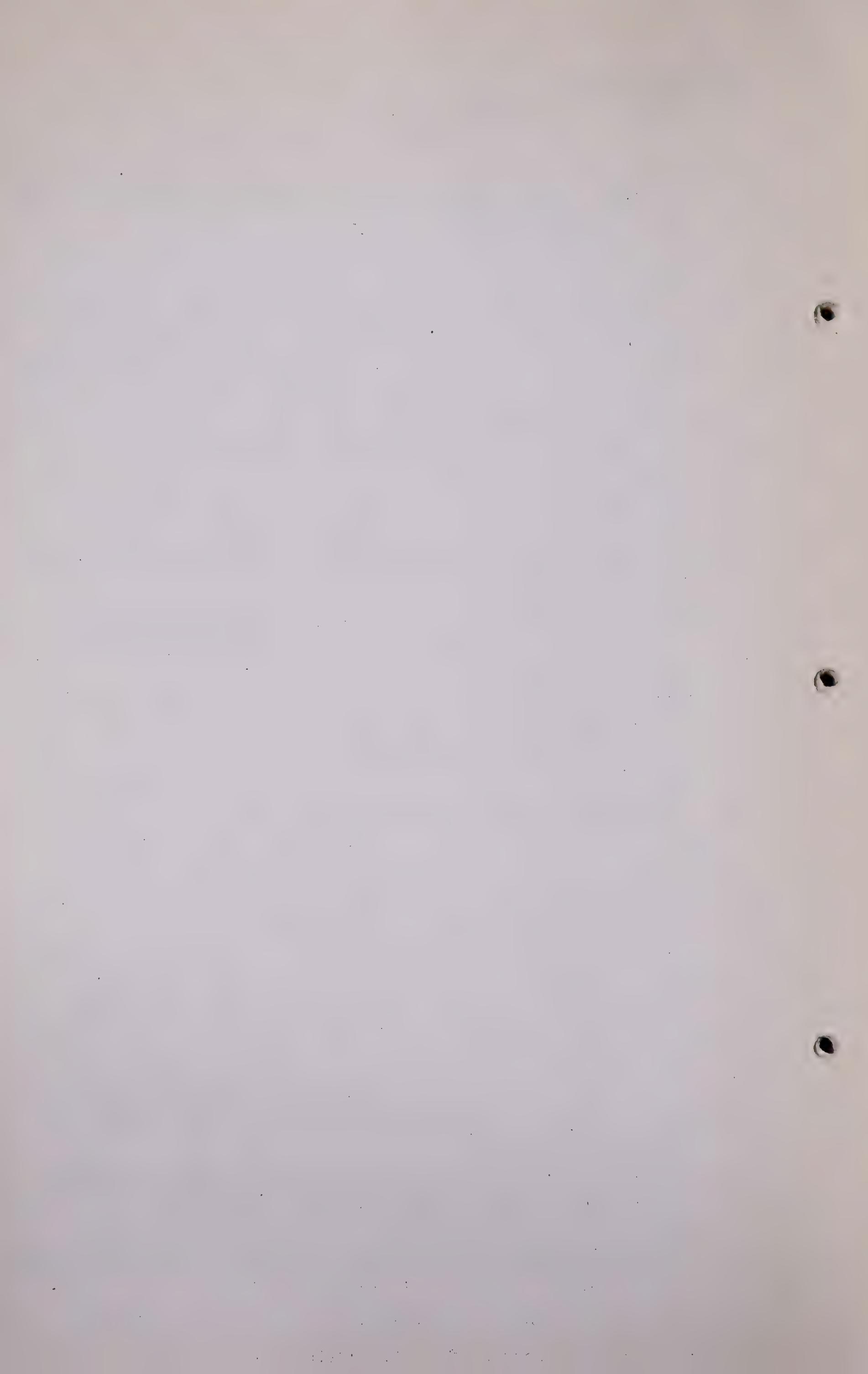
A That is correct, as part of the business.

Q So the net result is that the rates, the dollars and cents values of the assets you are paying for were those shown by Mr. Hill's report?

A That is right.

Q And with that in mind, will you tell me how you arrived at the 2,899,994 shares?

A The company was initially capitalized for 2,900,000 shares. Six of those shares were issued to the directors of the company for purposes of qualification and the remaining shares



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were issued to Royalite as consideration for the transfer of the physical assets to Madison.

Q Without reference to any price per share at all?

A That is correct.

Q I see. And it just happened to be 3 million shares that it was capitalized for was it?

A No, 2,900,000 common shares and not 3 million.

Q I am somewhat puzzled about this because it is something new. . .

MR. CHAMBERS: I think in fairness to the witness, Mr. Fenerty, I should say this. I take the responsibility for the share set-up of this capital and advised on it in view of Mr. Hill's report. These assets were transferred in consideration of these shares. There was no specific value put on any one item.

THE CHAIRMAN: What is the relationship between Mr. Hill's valuation and the issued capital? I have forgotten the totals.

MR. CHAMBERS: Mr. Hill's figures are somewhat less, taking a dollar a share, it is somewhat less.

THE CHAIRMAN: Less than Mr. Hill's revised value. I have forgotten. 2,500,000?

DR. BOOMER: \$2,537,000.

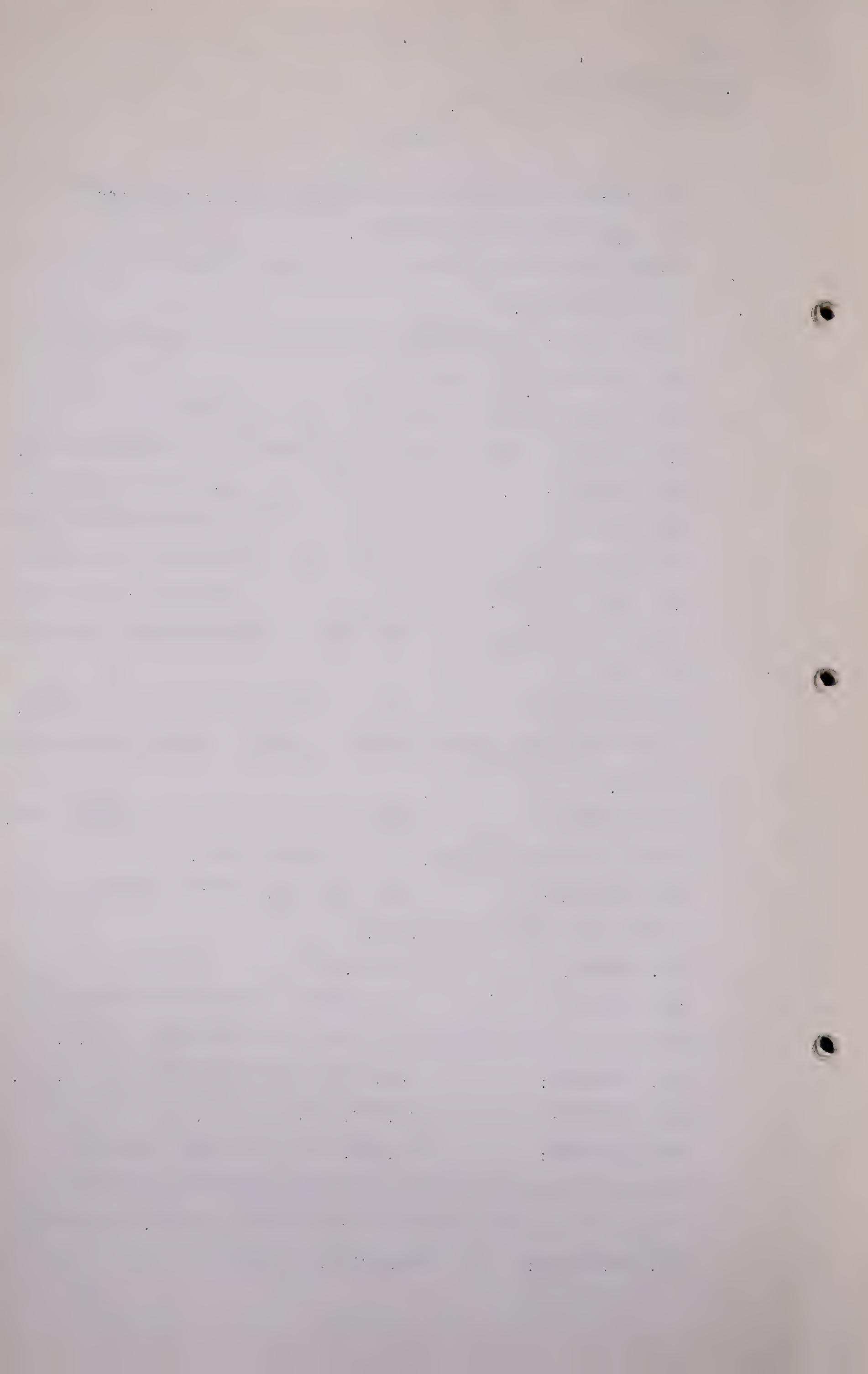
MR. FENERTY: The Charter calls for a dollar a share and I was wondering if there was anything

MR. CHAMBERS: Mr. Hill's final figure is

MR. FENERTY: \$2,527,964.

MR. CHAMBERS: \$2,527,964 and those were the physical assets . Madison got these physical assets and they got all these contracts in return for 2,998,994 shares.

MR. BLANCHARD: Plus \$100,000 cash.



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MR. CHAMBERS: \$100,000. cash was included.

MR. FENERTY: Is my friend serious on this?

MR. CHAMBERS: Yes, I am serious.

Q MR. FENERTY: Are you serious in this? We are going to have a capital value of so many non-par shares and not so many dollars at all is that it?

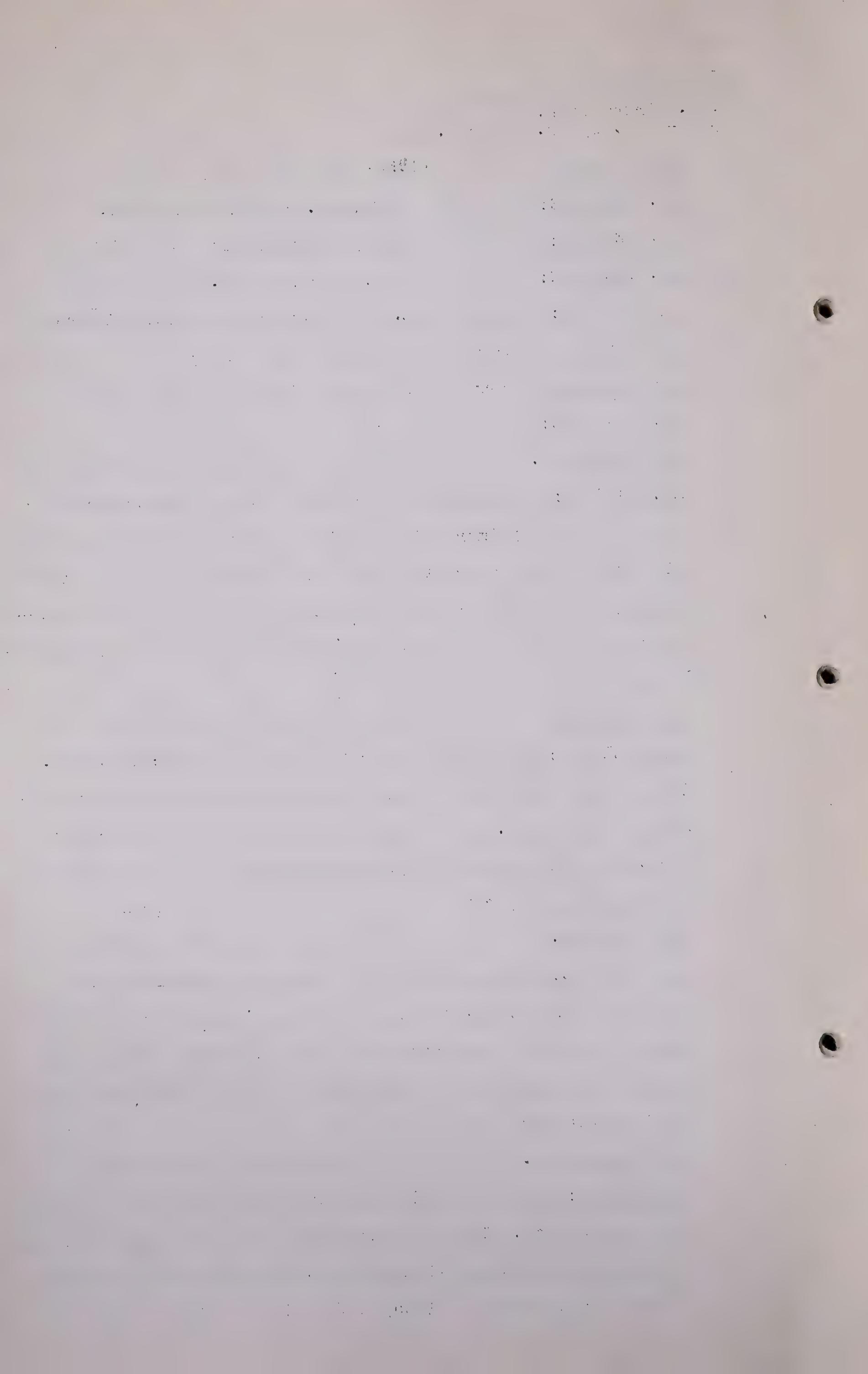
MR. CHAMBERS: I cannot understand what you are talking about.

MR. FENERTY: The reason we cannot understand each other is that my impression is that a no par share is dealt with in dollars and cents when it is disposed of and that when you say you sell something for a no par share it is no indication of the value of an asset at all, unless you know whether the shares are being dealt with on the basis of 100 dollars or 1 cent.

THE CHAIRMAN: You can do it arithmetically. Dr. Boomer has just used the slide rule and he tells me that outside of the \$100,000 cash the shares would be $87\frac{1}{2}$ cents each. Then I suppose the proper question to ask is there is a discount of $12\frac{1}{2}$ cents per share and what is represented by the discount.

MR. CHAMBERS: There is no discount. I submit that the dollar mentioned in the company's charter in the case of a no par share has no relation whatever to what the shares are set up on the books of the company. That it is merely a standard for the payment of fees to the Department and that is all.

MR. FENERTY: I do not want my learned friend to misunderstand me. I do not suggest he has not thought about this and thought about it at length. But I do suggest he has produced an abortion. I say this thing has to be cleared



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up because it is serious. He does not have so many shares at so much money which is all you can say about no par shares and if this thing is deliberate we have to find out something about it. If it is not deliberate let us get down to a basis.

THE CHAIRMAN: Mr. Fenerty, I see what your problem is and quite understand it but for your purposes does the capitalization of the company matter very much? Is it not the rate base that is important? Suppose they capitalize the company at \$10,000,000. and we gave them a rate base at a million and a half. Then the rest of it is their problem.

MR. CHAMBERS: If this were to shorten it at all, I will say here and now I do not suggest and I have never suggested that the rate base should be based on the number of shares that this company had issued or its capitalization. I never suggested it and never had it in my mind.

MR. FENERTY: I want to find out what this company bought this for. I mean did it do it by a system of barter. Are we getting back to the dark ages?

MR. CHAMBERS: I suggest we can do it by a system of barter.

MR. FENERTY: So many shares which may be 100 dollars or a dollar for so much property. I cannot find out what they mean by that, under that system.

THE CHAIRMAN: Mr. Kirkpatrick, could you between now and tomorrow prepare a statement which will show the basis upon which these shares were issued?

A I can prepare a statement which will show the amount shown by the Madison books which represents the assets on the asset side of the ledger. The equipment values which we have attached to the plant and equipment and other properties



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acquired as a result of this exchange of shares. I can do that but I may say with perhaps a minor exception here and there it will tie in with Mr. Hill's report. We will be very happy to prepare that.

Q MR. FENERTY: That might solve it. Now, Mr. Kirkpatrick, in getting at these values, we have heard that Mr. Hill made these valuations to the Royalite Company. I take it as far as Madison is concerned of course it just accepts Royalite's figures. Does it accept Royalite's figures?

A Well, Mr. Hill's valuations of course were reviewed by Madison.

Q Yes.

A As a consequence of that review we drew to his attention some of the omissions and exceptions which he had adjusted in his Exhibit 60.

Q Now Madison, we all recognize, is a wholly owned subsidiary?

A Exactly.

Q And Madison is incorporated and was prepared to take over at whatever figures the valuation obtained by Royalite showed.

A Whatever Mr. Hill's report showed, yes.

Q THE CHAIRMAN: Am I right in this, Mr. Kirkpatrick, that when you allotted the shares to the Royalite Company you were working on Mr. Hill's unrevised valuation?

A Yes.

Q Which was at that time \$2,487,704.?

A Something in that neighbourhood, yes. Mr. Hill's revised valuation was not prepared until his most recent visit here.

Q And your allotment was made prior to the revised valuation?

A Yes, sir.

Q MR. FENERTY: Now, Mr. Kirkpatrick, in fixing these valuations was any consideration given to the allocation of the equipment as between Royalite and the Madison Company?



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A I am sorry, I did not understand your question. Any consideration given to the allocation of the equipment. You mean perhaps the equipment jointly utilized in the two services?

Q Your company is a separate corporate entity. You are an officer of that company. Did you give any consideration to what assets you would take over or would you just take over what Royalite suggested you should take, is that it?

A We took what was shown in the report for the reasons that we presumed they formed a natural part of the operations of the natural gas division. Obviously we would not want to take over from them anything which was not directly related to this operation.

Q I might pursue this for some time and it is one o'clock. Perhaps I had better stop. The thing I want to get at is this division and I want to refer to that now so that I will have it available.

MR. BLANCHARD: Mr. Chairman, just before the witness goes, Mr. Milner spoke to the Board about the absence of Mr. Steer and asked me to request the balance sheets of the Madison be available for cross-examination or for inspection by Mr. Steer. I thought if the witness is going to produce something tomorrow, he might be prepared at the same time to be ready with them. I assume Mr. Steer will be here tomorrow. I do not know. Is that so?

THE CHAIRMAN: Mr. Milner said he did not know.

MR. BLANCHARD: I am just mentioning that in case he is here.

Q THE CHAIRMAN: You will do that, Mr. Kirkpatrick?

A Yes, sir. I will not have thirty copies. I only have a few.

(At this stage the Hearing was adjourned until 9.30 a.m. 17th. of April, 1945.)

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